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RAILROAD SHIPPER CONCERNS

HEARING

BEFORE THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION
AND MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

JULY 31, 2002

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ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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RAILROAD SHIPPER CONCERNS

WEDNESDAY, JULY 31, 2002

U.S. SENATE,
SUBCOMMITTEE ON SURFACE TRANSPORTATION AND
MERCHANT MARINE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:45 a.m. in room SR–253, Russell Senate Office Building, Hon. John B. Breaux, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. JOHN B. BREAUX, U.S. SENATOR FROM LOUISIANA

Senator BREAUX. All right. We will now take off the maritime hat and begin our hearing on the railroad shipping interests. I will have a brief opening statement, and then we will proceed with our witnesses.

The Committee is here today to complete a series of three hearings. This is the third of a series on the state of the railroad industry. Today's hearing will explore whether the current regulatory process is adequate to ensure that the railroads do not act in an anticompetitive manner, to the detriment of railroad shippers.

These concerns are not new. Railroad regulation dates back to the enactment of the original Interstate Commerce Act back in 1887, which created the Interstate Commerce Commission to regulate the practices of railroads operating in interstate commerce. Though much has changed in the industry since then, the primary interests at stake have not.

The issues here are complex. As I see it, we have two objectives that we need to achieve. On one hand, the Government needs to ensure the stability and growth of the Nation's economy through maintaining a healthy freight railroad industry. For instance, as early as the mid-1900's, in order to populate the West and harvest the resources of the western and Great Plains States, the Federal Government and the State governments provided land grants and subsidies to railroads to help them build the infrastructures. These actions reflect the importance of railroads to the Nation's economic development, and also recognize the importance of the Federal Government that we place on freight railroads.

On the other hand, these same policies that help stimulate development of the railroad system in our modern economy also resulted in the railroads becoming the dominant mode of freight transportation in certain areas of the Nation. Because of the efficiencies they are able to realize, some railroads essentially are monopolies in the transportation of bulk commoditiee with no competition from other modes of transportation that provided efficient and effective alternatives such as barges or pipelines.

Just as with any monopoly, the Government has a legitimate role to step in to regulate to ensure that market power is not abused in such cases. The same tensions and battles that existed over 100 years ago still exist today, and from time to time we need to evaluate the effectiveness of our methods for balancing these two objectives, whether through regulation or through private sector dispute resolution, or some method combining the two.

In 1980 we deregulated an admittedly financially unhealthy railroad system, and provided the railroads with greater flexibility in the provision of service and price. At that time, there were 40 Class I railroads operating in the United States. Today, there are eight Class I railroads.

I doubt any of our witnesses will contest that it is in our Nation's interests to have a healthy and viable system of freight railroads. I am a strong believer in competition, but in order to have competition, you have to have competitors.

We are here today to hear from rail shippers in particular to determine whether our current policies about railroad regulation are effective. I believe in marketplace competition, but in the absence of effective marketplace competition the Government has a legitimate role in seeing that everyone is treated fairly. With that, I would recognize our distinguished Chairman.

Mr. Chairman, this is our third hearing on the question of railroad rates.

[The prepared statement of Senator Breaux follows:]

PREPARED STATEMENT OF HON. JOHN B. BREAUX, U.S. SENATOR FROM LOUISIANA

Good morning. Today's hearing will complete a series of three hearings that this Committee has held on the state of the railroad industry. The purpose of today's hearing is to explore whether the current regulatory process is adequate to ensure that railroads do not abuse their market powers to the detriment of railroads shippers, and ultimately to our economy. While we are here today to primarily hear from the customers of the railroad, we must also keep in mind, that it is in the best interests of all concerned that this nation have a healthy railroad system.

This is not a new issue. In fact, the same regulatory issues the Committee will explore today date all the way back to the enactment of the original Interstate Commerce Act in 1887 which created the Interstate Commerce Commission to regulate the practices of railroads engaging in interstate commerce. An action that was approved by this Committee, I might add. Through time, railroads and their shippers have sat through hundreds of hearings, if not thousands of hearings, all pleading their cases for; a fair process, a fair way of regulating against abuse of power, for the proper degree and provision of service, or for proper returns on investment. So, our witnesses here today follow a long tradition of concerned carriers and shippers, and all manner of experts in the field of transportation. Essentially, the times and the equipment used in rail transportation have changed, while the issues have not markedly changed since the 1800's when the federal government first grappled with the same issues we will consider today.

This is a difficult issue because we have two principal objectives to balance. First, the government, rightly, wants to stimulate the growth and expansion of the railroad industry to spur economic growth and expansion throughout the entire country. For instance, in the mid 1800's, in order to populate the west and harvest the resources of the western and great plain states, the federal and state governments provided land grants and subsidies to construct railroad lines. The construction of these railroad lines was crucial to the development of our nation and to emergence as an international economic power. Not only did these policies lead to the population of the west and development of agricultural and other natural resources, but it helped to stimulate the development of an industrial economy mobilized to process and manufacture these western shipments arriving by rail.

The same policies that helped stimulate development of the rail system and our economy, and resulted in the railroads becoming a dominant mode of transportation, also created a dependance on railroad service, and a need to regulate railroad behavior to protect against abuse of power. Because of their efficiency and the ability to lay track through varied terrains, railroads effectively have monopolies in the transportation of large volumes of bulk commodities in certain areas, and entire regions dependant on the production of these bulk commodities were captive to the railroad. The government had to step in to regulate those railroads that did not have competition from other alternative modes of transportation, such as barges or pipelines, to make sure that they did not abuse their position of power.

That same tension that existed over 150 years ago or 100 years ago, in the days of JP Morgan, James Hill and Jay Gould, still exists today. However, while the tension is the same, it is incumbent that we evaluate the state of competition given the current system of rail service that exists. We have to evaluate the need for regulation based on the state of competition in the industry. My predilection is ordinarily to support competition, and to oppose the mandate government intrusion into commerce, however, if the competition is of such a limited nature or quality—I firmly believe that the government has a right, if not an obligation, to take steps to prevent abuses that result from the lack of competition.

In 1980, we deregulated an admittedly unhealthy and over-regulated railroad system, and provided railroads with greater flexibility in providing services and determining price. In 1980, there were 40 Class I railroads operating in the United States, today there are 8 Class I railroad systems.

I strongly believe that it is in our nation's interest to have a healthy and viable system of railroads. However, today we will hear from shippers in particular, to determine whether the degree of railroad concentration and power is too great, and to determine whether the existing regulatory structure includes sufficient protections to ensure railroads do not use their position of market dominance at the expense of our country's economic health. Recently I received a letter signed by hundreds of shipper CEO's stating that there is a problem with the existing regulatory structure. Today, I hope we can discuss possible solutions. I look forward to this morning's testimony.

CHAIRMAN HOLLINGS. And Mr. Chairman, I appreciate your leadership, and particularly this hearing. I have another commitment and need to duck back upstairs. I just want to commend Linda Morgan, the Chairman of our Surface Transportation Board. She served for many, many years as the general counsel of our Committee here, and when she got this particular post I knew she would do a good job, but I did not know she would satisfy everybody. I do not know how you satisfy everybody in this town, but I think she has done an outstanding job, and I appreciate the task and the job and the leadership that she has given to the problems of surface transportation.

Thank you very much.

Senator BREAUX. Thank you, Mr. Chairman. We all echo that sentiment. Ms. Morgan, do you want to respond to your Chairman?

Ms. MORGAN. Just to say thank you very much, Mr. Chairman, and you showed me how to do it right, so I am just following your lead.

Senator BREAUX. Senator Rockefeller, any opening statement?

STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Yes, Mr. Chairman, and I was moved by the exchange. I have somewhat of a difference regarding whether or not, Linda Morgan, you satisfy everybody, and we will go into that in the questioning period, but I just wanted to say——

Ms. MORGAN. I certainly would not argue with the Chairman on that.

[Laughter.]

Senator ROCKEFELLER. I know.

[Laughter.]

Senator ROCKEFELLER. And that has sort of run through these years just a bit.

Obviously, Chairman Breaux, I am happy that we are doing this. The STB determines the major players in the rail industry are not revenue adequate, has for years. I will have questions of them, as I will of you, Chairman Morgan, about all of this.

This industry, the railroad industry, is incredibly important to the State of West Virginia. I do not know of anybody in this building or in this town who cares more about railroads and what they do, both being good and efficient, as well as being responsive, than I do. I think that has been the case now for some 18 consecutive years. What they are doing to many shippers in my State and Senator Dorgan's State and all of our States is using what I would call regional monopolies, based upon the fact, as the Chairman said, that they have gone from 50 Class I railroads, I would say to five, he would say to eight. It does not really matter. It is a strong reduction, and they are using those monopolies to gouge their customers. I do not know of any other way to put it. I tried to think of a nicer term, but I could not. By extension, therefore, this impacts every single customer that they serve, in the country, where there is not competition involved in the railroad line.

There are some who say that my goal is to re-regulate the railroad. That is so ludicrous. My goal has always been simply to carry out the purposes of the Staggers Act, which was very clear. It has never been to re-regulate. If I wanted to re-regulate, there could be all kinds of other things that I and others could do. I am not interested in doing that.

If I had to start all over again, knowing what has happened in the intervening years, and had I been in the Senate, in the Congress when the Staggers Act was passed, I do not think I would have voted for it knowing what I now know. I did not know that there was not going to be a focus on small shippers and large shippers, and I notice in the meeting this morning we have smaller shippers. We do not have large shippers. But I am interested in both railroads and I am interested in shippers, and I want that to be clear to all present.

The railroads are always seeking to merge, and they always promise better service, and it does not come to the people that I am concerned about, and I think I have a right, in sincerity and a sense of honor, to be worried about that 20 percent of the shippers of this country which are not served by competition. That is a lot of people. That is a lot of jobs. We do a lot of things to try to help people. We undo a lot of things by not, in my judgment, at least enforcing this Staggers Act aspect. I would just say that when the system runs the way it appears to have been running for all these years, I think that everybody loses. Even the railroads I think lose, because if you have to use monopoly power against the shippers, they then suffer financially, and of course no group suffers more than the consumers at the end of the line, because they have to pay too much.

It strikes me as sort of incontrovertible logic, and we have been through a lot of things. I will not go through some of the things we have been through before during our discussions this morning, but I am kind of stunned by the last 18 years. I understand some of the relationships and politics and all the rest of it, but I really do think about hundreds of thousands of shippers in this country. I really do think about the mergers. I really do think about the service.

I think about what happened out West of the Mississippi when they had that foul-up, and the problem of Norfolk Southern and CSX in splitting up Conrail, two different cultures, what has happened to coal, steel, granaries, all the rest of it. It is a very serious subject. It has not been addressed under your tenure, Chairman Morgan, in my judgment. It has not been addressed by the Congress, and I regret that.

Mr. Chairman, I thank you.

Senator BREAUX. Thank you, Senator. Senator Dorgan, any comments?

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Yes, Mr. Chairman. Thank you very much.

First of all, we appreciate this hearing. You made a commitment to have this hearing and are keeping that commitment. My hope is that we will also get a commitment to move legislation in this Congress. We are almost out of patience, those of us who have been waiting a long, long while to try to move some legislation.

Part of the reason we want legislation moved is, Ms. Morgan has told us that she does not have the authority to do all that Senator Rockefeller, myself, and others would want her to do. I do not know whether that is the case. I have not had a battery of lawyers study all that. Some of what has happened at the STB, such as the decision by the STB for a moratorium, I supported. I thought that was gutsy. That was a moratorium on mergers. They took a step that I think was aggressive.

In other areas, as Ms. Morgan knows, I have been less than enthused, because I would like a regulatory body to be aggressive and active, and trying to find as much ability as they can to use the authority that exists to try to write the wrongs.

Mr. Chairman, I have long had a fascination with railroads and trains. I grew up in a town of 400 people, and when the train whistle blew in our town we knew that the train called the Galloping Goose was going to come through our region. It was going to stop and pick up cream cans. I mean, it stopped at the cream station, and the Galloping Goose would come, pick up cream, and away it would go. It was a big deal. I mean, when I was a kid my eyes were the size of dinner plates when that train would come through. I liked watching that train. I have always had a fascination with trains.

But as I grew up and understood what is going on with respect to trains and railroads in this country, it is clear to me that what has happened is, we passed the Staggers Act and through a whole series of things we now come to a country with essentially two railroads on the west side and two railroads on the east side that command most of the traffic and most of the activity, and the fact is, when you have fewer participants, you have less choice.

When you have less choice, you have less price competition. Less price competition means that those who are captive shippers are held captive by those who want to extract prices that are unfair, and that is why we have been left with deregulation that gives us regional monopolies who can, and do use their muscle to price in ways that are unfair.

I think it would be interesting to tell you about a hearing I held in Bismarck, North Dakota. North Dakota is a big state. It is ten times the size of Massachusetts. There is a farmer that lives near Dickinson, North Dakota, which is on the west side of the State. We have a railroad serving our state, Burlington Northern, a big old carrier that serves our state. They decided to impose what was called inverse rates, inverse rail rates. It was rates that they devised for certain areas of the state, and our grain elevators protested it and farmers protested it. They thought it was unfair.

Let me tell you the example of what inverse rate pricing did for one farmer in Dickinson. That farmer put his grain on a truck from Dickinson and moved it 160 miles east, 160 miles east, and he made 50 round trips, put 16,000 miles on his truck, to load the grain 160 miles east of his farm, and then the train with his grain came right back through his farm on the way to the West Coast.

Why did he do that? Because of inverse pricing, inverse rates, the railroad said, "here is what we charge, do not like it, tough luck, there is not a thing you can do about it." Now, they have made some alterations just in the last month on that, and good for them, but my point is, that farmer thinks that this strategy is just nuts, and injures him. It injures those who are captive shippers, and ought not be allowed to stand. That is just one example, and there are so many others.

If you are shipping wheat from the middle part of North Dakota to the Pacific Northwest, as opposed to shipping it from Grand Island Nebraska, we are 400 miles closer, but we will pay $1,000 more per car. If you are shipping to the Gulf of Mexico, we will pay $1,700 surcharge per car. If you are shipping corn, it is $500 cheaper to ship it from Iowa to the Northwest, which is much further, than to ship it from North Dakota to the Northwest. Why? Because that is what the railroads say they are going to do, and if you do not like it, tough luck.

Try getting a rate case through a regulating body. I mean, it has changed a bit, but the fact is, it is expensive, almost impossible, and if you are very lucky your great-great-grandchildren will be around to see the result.

So you know, what we are trying to do is say, let us even the odds a bit. The market system works when you have competition. There is limited competition here, monopoly pricing. Railroads use their muscle to extract prices they choose to extract, and you know, we think we need to even up the odds. We need to have regulators who regulate. They need the authority to regulate effectively, and we need legislation of the type that we have talked about, the Rail Competition Enforcement Act, which takes away the special status the railroads enjoy by being the only industry whose mergers are not subject to Justice Department review, and then the second bill, called the Railroad Competition Act, which is a bit more complicated, but is critically needed, in my judgment.

Now, having said all of that, let me also end as I began. This is not just about wheat. It is about people that ship chemicals and coal and so many other commodities, and it is about people on Main Street and on America's farms who have to pay that shipping cost, a cost that in many ways is now applied in a very unfair way.

You can make a case, as some will, that rail rates have actually come down in some areas. Yes, that is true. That is certainly true, and I concede that. It is also true that in areas where you have monopoly service, prices have gone up, up, way up in a terribly unjustified way.

So, Mr. Chairman, I must say a lot of us are nearly out of patience on this issue. We have been struggling for a long, long time just to take a baby step forward, and we have not made much progress, because there are a lot of bodies blocking the way. What is happening in this country with rail rates is fundamentally unfair to a lot of small businessmen and women, family farmers and other shippers. We have a responsibility, working with the regulators, to change it.

Thanks for your indulgence. I took more time than I expected, but I think it is very important.

Senator BREAUX. Thank you, Senator. I know your interest in this matter.

Senator Allen from Virginia.

STATEMENT OF HON. GEORGE ALLEN, U.S. SENATOR FROM VIRGINIA

Senator ALLEN. Thank you, Mr. Chairman. I thank you for calling this hearing to discuss the state of freight railroad transportation in our country. I am pleased that you are focusing on this issue. I am not a member of the Subcommittee, but have a keen interest in this matter as do, I think, all Americans, in that we recognize the railroads play a vitally important part of our economy.

As was stated by Senator Dorgan, it is not just about wheat and grains. About 50 percent of everything that we consume or use, whether it is automobiles, equipment, chemicals, and Senator Rockefeller knows coal in particular, are transported by rail. When one considers railroads and how important they are to our economy, he also recognizes that they are environmentally friendly. It is an efficient way of transporting all goods and products, and it thereby makes us less dependent on foreign oil. When you consider the hauling of coal, that means rail is fueling our main source of electricity as well.

Also, by using rail, as opposed to trucking, we reduce congestion on our highways.

Now, being from the Commonwealth of Virginia, we are very proud that we have two major railroads headquartered in Virginia, Norfolk Southern and CSX, and I am glad to see that John Snow is on this panel. I am also glad to see Ms. Linda Morgan is here on the first panel. My view of Ms. Morgan and her leadership, she is no-nonsense, she is fair, she is practical, she has been a very strong leader, and I thank you, Ms. Morgan, for your dedicated leadership in some very, very trying times. I think everyone, regardless of whether they liked your decisions or not, recognized you came about them in a fair, impartial, and pragmatic way, and thank you for your service.

Now, the railroads in Virginia mean a lot to us, obviously, with jobs and economic contributions and so forth, but let us look at history since the Staggers Act in 1980. The Staggers Act was a successful policy program created by Congress. Since that time we have experienced a rebuilding and renewal of the industry.

The employees and the companies have made significant technological innovations and investments of $260 billion in capital to rebuild the infrastructure with advanced, more modern locomotives and replenished freight car fleets. These investments have enabled the industry offer a better quality service. The railroads also have been able to squeeze more efficiencies into their systems, and regardless of what you may read, the railroads are operating more safely, and prices for their services based have declined.

I know that there are several bills before this Committee which could conceivably undo the progress the railroads have made since 1980. I think that we ought to be looking at competition. When one worries about antitrust matters, having watched the acquisition of Conrail by CSX and Norfolk Southern, that was not some easy slam dunk issue. That was a very, very difficult negotiation. The Surface Transportation Board had a great rule. Everything the Department of Justice would have done the Surface Transportation Board did with its leadership.

On top of it all, you had the two railroads vying for different stretches of Conrail, which was a Government-run railroad for all intents and purposes, and clearly a monopoly. Then you had the different jurisdictions in cities and what they wanted to see done by the railroads, and so acquisitions and mergers are not a very easy matter to go through.

I am not sure of how more mergers will go forward, but nevertheless, I think the acquisition of the Conrail system by Norfolk Southern and by CSX has actually created more competition, has been a benefit to the Northeast, where they only had one railroad serving, for example, the Port of New York and New Jersey. Now they have two railroads serving that port, so that has in my view been beneficial.

I think that competition should be the rule of the marketplace, obviously with sufficient safeguards in place, as there are now, to prevent rate abuses. It is important for the railroads and, obviously, their customers to work together to address their contract and pricing issues outside of the scope of unnecessarily meddlesome or overburdensome Federal regulation. I think we ought to be creating a climate where the rail industry generates sufficient revenues to support investments and their infrastructure that are so critical, absolutely critical and essential for the railroads' ability to serve their customers.

So, Mr. Chairman, I thank you again for holding this hearing. I look forward to working with you as a Member of the full Committee to make sure that all our shipping industries, including rail, can best serve the carriers, shippers, retail establishments, our ports and consumers as well, and I thank you again.

Senator BREAUX. Thank you, Senator, and thank all of our colleagues. I would observe for all of our colleagues that we are supposed to have sort of a vote-a-rama with I think four votes beginning at approximately 11:00, so we are going to ask our witnesses to summarize when they can, so we can proceed to questions.

We are delighted to have Chairman Morgan as our first witness. Linda, welcome back to the Committee, and I echo the fine compliments that you received from our other colleagues for the job that you have done, and we welcome you to present your testimony.

STATEMENT OF HON. LINDA J. MORGAN, CHAIRMAN, SURFACE TRANSPORTATION BOARD

Ms. MORGAN. Thank you very much. As you know, I have submitted written testimony which I would ask be included in its entirety.

I have listened to the opening statements, and I am prepared today to discuss railroad rates and competitive options and, in particular, the case-handling process at the board. I know in particular that there will be concern expressed today by shippers about how long it takes to resolve rail rate cases. I certainly understand and appreciate that concern. In fact, one of my highest priorities since I have been Chairman has been to expedite the board's decision making process, and we have taken specific steps to move rate cases along and to resolve them.

As we continue to focus on how to better move these cases along, we should keep several facts in mind. First of all, as we all know, railroad economics are not simple. Railroad business is made up of competitive and captive traffic, and there are many costs associated with providing service to all of this traffic that need to be recovered.

However, a simple cost-based formula for cost recovery does not work for the rail industry. The rates for competitive traffic cannot be raised high enough to cover its share of cost without diverting that traffic to other modes, so some shippers do pay more than others, and the board's job is to develop rate procedures that protect captive shippers from paying too much. The stand-alone cost methodology, the so-called SAC process, does that better than any other approach by making sure that no shipper pays a cross-subsidy for facilities from which it does not benefit, but the SAC analysis is not a simple one.

Even given the complexity of the process, the board has focused much attention on doing what it can to streamline the rate case process and establish appropriate substantive ground rules for the disposition of these cases. It has set deadlines, put limits on discovery, simplified market dominance procedures, and provided for the pursuit of certain challenges to bottleneck rates, resulting in four such cases being filed.

With these procedures in place, the board has resolved five large rail rate cases. Of these cases, four have been decided favorably for shippers, who have been awarded significant reparations. The board also decided one complex pipeline rate case in favor of the shipper.

In the past 2 years, nine new rail rate cases have been filed, perhaps in part a reflection of some faith in the rail rate process. Certain of these cases involve issues of first impression, as parties pursue new ways of looking at the rate review process.

One shipper witness here today is a party in one of those cases, presenting issues of new impression, and I know that it is concerned about the time that it is taking for his case to be resolved. While I cannot talk about the merits of that proceeding, I can say that we have already issued three important decisions in that case favorable to the shipper's position, with a fourth decision very much in process.

The original complaint has been amended to include new routings, and so the case now involves what could be viewed as three separate complaints requiring a different level of attention than the original complaint. The amended complaint has raised new issues about how the rate review process is to work, and the board's resolution of these issues will dictate how the SAC analysis is considered in the future.

In all of these rate cases, much time is spent at the front end of the process, with both sides filing motions about discovery and other pre-decisional matters. Particularly, with nine pending cases at this point, we understand the importance of resolving these matters as early as we can so that the process can continue, and I can assure you that we are continually revisiting our internal process to make sure that we can stay on top of this early phase.

In bringing these rate matters to closure, I am mindful of the old adage that the perfect should not be the enemy of the good, and that we cannot take too long to get it right, but given the importance of these cases, and the risks associated with decisions that are not upheld in court, we must try to get it as right as we can in as timely a manner as we can. Of course, there is always room for improvement, and we continue to take our responsibilities in this rate process area quite seriously.

There also continues to be concern about the burdens associated with bringing a small rate case. We have simplified procedures in place for these cases, but they are not being used. In this regard, I recently wrote the Committee summarizing the record compiled in a board proceeding that sought public views on whether Congress ought to legislatively mandate arbitration for small rail rate cases. I do understand the continuing concern in this area.

I also know that certain shippers believe that their rates would be lower if the board allowed for more open access and broader challenges to bottleneck rates. As I have said before, I believe that board decisions changing its rules in these respects would not be consistent with existing law, and would be difficult to defend in court.

As I have also said before, while the short-term impact of these types of actions would be to reduce rates in certain situations, the revenues flowing into the rail system would be reduced. This revenue reduction could very well result long term in a smaller system that we have today, serving fewer customers at different service levels, and possibly at higher rates. As we make decisions about the rail policy of the future, we must make sure that the result is the type of rail network that we want and need.

Before closing, just a personal note. As this is likely my last formal appearance before the Commerce Committee in this capacity, let me say that while the last 8 years have been challenging indeed, it nevertheless has been an honor and a privilege to serve in this way, which I have done to the best of my ability.

I would be happy to answer any questions.

[The prepared statement of Ms. Morgan follows:]

PREPARED STATEMENT OF LINDA J. MORGAN, CHAIRMAN, SURFACE TRANSPORTATION BOARD

Introduction

My name is Linda J. Morgan, and I am Chairman of the Surface Transportation Board (Board). I am appearing today at the Subcommittee's request to discuss issues of concern to railroad shippers. As I have testified about these and other Board matters numerous times before Congress in the past several years, my testimony today will offer a brief summary of the Board and its recent activities, with a particular emphasis on certain issues that are of concern to shippers.[1]

Overview of the Board

I first came to the Board's predecessor, the Interstate Commerce Commission (ICC), in the Spring of 1994, just before the House voted to terminate funding for the ICC. While legislation eliminating the ICC was not approved that year, Congress the next year did pass the ICC Termination Act of 1995 (ICCTA), which became effective on January 1, 1996. The ICCTA continued the trend toward less economic regulation of the surface transportation industry by eliminating the ICC and, with it, certain regulatory functions that the ICC had administered. The ICCTA established the Board as a three-member, bipartisan, decisionally independent adjudicatory body organizationally housed within the Department of Transportation (DOT). It transferred to the Board core rail adjudicative functions and certain non-rail adjudicative functions previously performed by the ICC, and provided it with limited resources to carry out these responsibilities.

The Board continues to be funded on an annual basis, operating at essentially the same resource level since its establishment in 1996, although, largely because of the debate over how the railroad industry ought to be regulated, the agency has not been reauthorized. Nevertheless, the Board has adapted to its mission and its resources. Even with limited resources, it has worked through its significant caseload, resolved many cases that had languished at the ICC, and tackled head-on the many hard issues that have confronted the rail sector in the last several years. In order to continue to perform its duties expeditiously and effectively, the Board's principal focus for the foreseeable future continues to be on hiring new employees capable of replacing the many experienced employees eligible to retire from the agency.

The Board's Approach to Its Work

The Board, I believe, has been a model of "common sense government," looking "outside of the box" for creative solutions to the serious regulatory issues entrusted to it, and promoting private-sector initiative and resolution where appropriate while undertaking vigilant government oversight and action in accordance with the law where necessary to address imperfections in the marketplace. This approach has been successful for addressing in a timely and effective manner a variety of difficult matters involving the rail sector.

For example, this approach worked in resolving the rail service crisis in the West during the late 1990s, which, as I have discussed with Members of this Committee on various occasions, had to be handled in such a way as to not inadvertently hurt some shippers in an effort to help others. The approach proved successful in addressing the less extensive disruptions associated with the Conrail transaction, and it has helped the Class I railroads in improving the operations of the Chicago terminal, a major gateway between the East and the West. Because of the Board's prodding, we now have industry-wide operational reporting that allows us to mon-

[1] In this Congress, I have provided testimony to this Committee on 3 occasions: 1) on March 21, 2001, I testified about the Board's activities in general; 2) on June 28, 2001, I gave testimony on the Board's recently issued major rail merger rules; and 3) I submitted testimony on the rail rate complaint process for the North Dakota field hearing on March 27, 2002.

itor carrier performance in a way that we could not before; we have more cooperation among carriers with a view toward expanding and improving rail service; and we have private-sector agreements and other mechanisms in place to address issues that arise between various segments of the rail sector. And the Board's pragmatic approach also has worked in many individual cases in which the Board has facilitated private-sector solutions. Such an approach can produce the best solution to a problem: a private agreement will more likely reflect the interests of the parties to the agreement; the parties who have negotiated the agreement have a real stake in its success; and a private-sector resolution can provide more benefit to the parties involved than the Board can provide, given the limits of its authority. As a result of the efforts of the last several years, interactions among the various stakeholders are more constructive and rail service is more responsive overall than in past years.

Sometimes a private-sector solution is not forthcoming, however, and in those cases we do intervene aggressively when appropriate. Thus, after holding extensive hearings on access and competition in the railroad industry, in 1998, in addition to promoting private-sector initiatives, we pursued a variety of government actions, including the revision of the "market dominance" rules to eliminate "product and geographic competition" as considerations in rate cases. Similarly, although some rate cases have settled, others have not, and in those cases the agency has acted decisively, in decisions that were more often than not favorable to shippers, to establish the rules of the road for the disposition of these important matters. And beyond the resolution of individual cases, I should note that the Board has handled tough problems by issuing rulings of broad applicability. As an example, in its "bottleneck" decisions, the agency read the law creatively so that it could give shippers an opportunity for relief while respecting the rate and routing freedoms that the law provides for railroads. I know that certain shipper interests consider the bottleneck relief illusory, but in fact a number of bottleneck complaints have been filed before the Board.

Rail Rate Cases

Overview. When I came to the ICC, the agency had rate guidelines in place, but it had decided virtually no cases under these guidelines. One of my main goals as Chairman was to resolve these cases with a view toward clarifying how the guidelines would be applied so that parties would know where they stood, and leveling the playing field by ensuring that the formal process would not be used simply as a delaying tactic. Also, by setting up fair and understandable procedures, and focusing on timely case disposition, I hoped to encourage private-sector resolution whenever possible. I believe that we have achieved those objectives, as many rate disputes have been resolved without Board intervention, and several cases that had been brought to the agency were settled before the agency issued a decision. Of course, not all cases are settled, and we are actively moving forward with several rate cases at this time. Rate regulation, however, is not a simple exercise, and so the cases take time.

Market Dominance. Congress has decided that there should not be rate regulation where there is effective competition, and so the first step in a rate case is the determination of market dominance (defined as an absence of effective competition for the transportation to which the rate applies). The first component of a market dominance inquiry is to determine the "variable costs" of providing the service. The statute establishes a conclusive presumption that a railroad does not have market dominance over transportation if the rate that it charges produces revenues below 180-percent of the "variable costs" of providing the service, which means that this 180-percent revenue-to-variable cost (r/vc) percentage is the floor for regulatory scrutiny.

For situations in which the 180-percent threshold is met, the second component of a market dominance inquiry involves a qualitative analysis in which the Board must determine whether there are any feasible transportation alternatives that could be used for the traffic involved. Currently, in its market dominance determination, the Board considers actual or potential direct competition, that is, competition either from other railroads (intramodal competition) or from other modes of transportation such as trucks, pipelines, or barges (intermodal competition) for the same traffic moving between the same points. For many years, the ICC (and later the Board) also considered two other types of indirect competitive alternatives: geographic competition (the ability to use other railroads or modes to ship from or to other locations) and product competition (the ability to use other railroads or modes to ship substitute products). As referenced earlier, the Board no longer considers these forms of indirect competition because it found that they are unduly complicated for the Board to assess, that they prolonged the handling by the Board of rail rate cases, and that they discouraged shippers from pursuing legitimate rate complaints. (The Board's decision is still under judicial review.)

Rate Reasonableness Standards. Thus, although the market dominance inquiry is still not easy, we have tried to simplify it. And even assuming that the elimination of product and geographic competition will be upheld in court, the remainder of the rate review process is quite complex. Although a cost-of-service approach might be relatively simple, we cannot use such a methodology for two reasons. First, the full costs of serving each individual shipper cannot be measured directly, due to the high degree of shared costs (e.g., overhead costs) and sunk costs (e.g., costs for tunnels, bridges, etc.) in the rail industry that cannot be attributed to individual traffic. And second, railroads are not able to price their services based on preset cost allocations because they serve a mix of captive and competitive traffic, and the competitive traffic would not pay a pro rata share of costs assigned by a formula if the resulting rate is any greater than the rate for using competitive transportation alternatives. Thus, a preset allocation formula would drive away those shippers with less costly competitive options, and the remaining captive shippers would then have to pay even higher cost-based rates once the departed shippers would no longer be contributing to shared costs.

Accordingly, to limit the rates on captive rail traffic to reasonable levels while affording railroads the opportunity to cover all of their costs and earn a reasonable profit, the Board uses demand-based differential pricing principles. In other words, the Board expects railroads to apply differing markups (amounts by which rates exceed variable costs) based on the price sensitivity (degree of captivity) of the traffic. Shippers with more choices are offered lower markups in order to keep their traffic in the rail network and thus minimize the overall contributions to the railroads' shared costs needed from those shippers with few, if any, choices.

These pricing principles, which apply in many industries in addition to railroads, make determining the reasonableness of an individual rate a complex task. Neither attributable costs nor degree of captivity (demand elasticity)—the bases for demand-based pricing—can be measured directly. Therefore, to assess whether market dominant rates are reasonable, the Board uses a well established concept known as "constrained market pricing" (CMP) whenever possible. CMP principles recognize that, in order to earn adequate revenues, railroads need the flexibility to price their services differentially by charging higher mark-ups on captive traffic, but the CMP guidelines impose constraints on a railroad's ability to price differentially.

The most commonly used CMP constraint is the "stand-alone cost" (SAC) test. Under the SAC test, a railroad may not charge a shipper more than what a hypothetical new, optimally efficient carrier would need to charge the complaining shipper if such a carrier were to design, build and operate—with no legal or financial barriers to entry into or exit from the industry—a system to serve only that shipper and whatever group of traffic is selected by the complaining shipper to be included in the traffic base. The ultimate objective of SAC in particular, and CMP in general, is to eliminate unwanted cross-subsidies from one shipper to another and to have optimal efficiency reflected in the rate base. Thus, the SAC test allows railroads to price differentially, but it limits rates through the hypothetical efficient new railroad model by assuring that a captive shipper not be required to unreasonably subsidize a carrier's competitive traffic by being forced to bear the costs of any facilities or services from which the shipper derives no benefit.

The Board has used this test to resolve five rate complaints since the agency was established at the beginning of 1996 (cases brought by West Texas Utilities Company, Arizona Public Service Company, McCarty Farms, Inc., FMC Corporation, and Wisconsin Power and Light Company), and the test is being used to evaluate the reasonableness of rates in several ongoing cases. The Board has also established procedures for expediting these cases. While presenting a SAC case is not inexpensive, large rail shippers have used it to obtain substantial rate relief (with decisions favorable to the shippers in 4 out of the 5 cases cited above).[2] One complainant shipper, for example, was awarded over $10 million in reparations for past shipments, and obtained a rate prescription that lowered its rate for future shipments by 30-percent. Another shipper was awarded over $20 million in reparations and obtained a 40-percent rate reduction.

Timing Issues. Some parties argue that it takes the Board too long to decide rate cases. I understand their concern. However, the review is an inherently complex one. And the parties themselves add to the time needed for resolution by asking the agency to resolve numerous discovery disputes, many of which they ought to be able to settle themselves, as well as other preliminary matters. With respect to the cases themselves, we must make hundreds of "calls" on the many substantive issues that come up in each proceeding. As these cases are data-intensive and quite technical,

[2] The Board also resolved during this period a complex pipeline rate case in a judicially affirmed decision that resulted in substantial rate reductions and reparations.

we have to be very careful, because a mistake on even one of these issues could result in a remand by a reviewing court. And we also have to spend considerable time on administrative petitions for reconsideration that are frequently filed, as well as court challenges to our rate decisions. All of this is handled by a small cadre of highly skilled and dedicated employees, who I can assure you are focused on producing a defensible product in these and the many other cases on which they work.

Additionally, I should note that the nature of the calls that we are required to make has changed with the recent filings. In the past, the questions that arose—even the theoretical questions—typically concerned more confined issues such as how to value property, the configuration of the hypothetical railroad's network, and the projections of the tonnage and revenues associated with the hypothetical railroad. More recently, however—now that many of those matters have been resolved—parties have attempted to test the boundaries of a SAC case, and so we have been faced with a series of issues that go to the broad principles underlying the SAC analysis. Rather than resolving these questions after the parties and their consultants have made their entire cases, we have been called upon to address them at an earlier stage in order to guide the parties in presenting their evidence and arguments. Thus, late last year, we published a decision providing guidance on certain fundamental issues outstanding in several pending cases, including the *Arizona Electric* case. The *Arizona Electric* parties asked for further guidance, and we expect to issue a further decision in the very near future on that matter.

Small Rate Cases. In 1996, the Board issued simplified guidelines for the disposition of those rate cases where the amount of money involved does not justify pursuing the more complex method used in larger cases. No case has been filed seeking application of those guidelines, as some may view them as not being simplified enough, and not worth bringing given the amount of money at stake. In December 1998, I wrote to the Committee on a number of matters and suggested that, if Congress shared that view, legislation would be necessary to establish another approach. In May of this year, I again wrote the Committee summarizing the mixed record developed in a Board proceeding that explored whether legislatively mandated arbitration might be an appropriate approach to handling these cases.

Rail Mergers and Competition

Background on Past Rail Mergers. The trigger for much of the debate over access and competition was the move during the 1990s toward continued consolidation in the railroad industry. Since I came to the ICC, four Class I rail mergers have been approved, with substantial Board-imposed competitive and other conditions. The conditions in a variety of ways provided for significant post-merger oversight and monitoring that have permitted us to stay on top of both competitive and operational issues that might arise. They provided for the protection of employees and the mitigation of environmental impacts, and our recent decisions employed a "safety integration plan" that draws on the resources of the Board, the Federal Railroad Administration, and the involved carriers and employees.

In varying degrees, these mergers have had the support of segments of the shipping public, as well as employees and various localities, and were considered by a number of interested parties to be in the public interest. A variety of shippers actively supported the Burlington Northern/Santa Fe (BN/SF) merger, the inherently procompetitive Conrail acquisition, and the Canadian National (CN)/Illinois Central merger. While the Union Pacific/Southern Pacific (UP/SP) merger was opposed by certain segments of the shipping community (although it was supported by others), the Board believed that merger was necessary not only to aid the failing SP, but also to permit the development of a second rail system in the West with enough presence to compete with the newly merged BN/SF. I should note that the conditions that the Board imposed in approving the UP/SP merger made it possible for UP/SP's main competitor, BNSF, to participate in several "build-outs" designed to produce new competitive service that did not exist before the merger, and that would not have been possible without the Board's conditions.

Some have said that rail mergers are inherently anticompetitive, that they cause service problems, and that the agency should have more actively discouraged them. But our approvals were based on public interest determinations made on extensive records and were conditioned to preserve and promote competition, ensuring that no shipper's service options were reduced to one-carrier service as a result of a merger.

New Major Rail Merger Policy and Rules. These recent mergers have changed the way the rail system now looks. In the United States, we now have two competitively balanced systems in the West and two competitively balanced systems in the East. Future merger proposals would likely result in a North American transportation system composed of as few as two transcontinental railroads.

Given this prospect and the service disruptions associated with the most recent round of mergers, when the BNSF and CN rail systems announced their intention to merge in late 1999, the Board issued a 15-month "moratorium" designed to prevent the filing of merger proposals pending the development of new rules.[3] Before the moratorium ended, the Board revised its rail merger policy with a view toward more affirmatively enhancing competition, and ensuring that the benefits of a future merger proposal truly outweigh any potential harm. Given that the next round of mergers would put in place the rail network of the future, applicants under the new rules bear a substantially heavier burden in demonstrating that a merger proposal is in the public interest. Key provisions in the rules require applicants to more clearly show that the transaction would promote competition and improve service, and indicate that enhanced intramodal competition would be viewed as a benefit weighing in favor of approval. The rules also direct more accountability for benefits that are claimed and a showing that such benefits could not be realized by means other than a merger. And they require more details up front regarding the service that would be provided, as well as contingency planning and problem resolution in the event of service failures.

Some say that, if the current industry structure warrants conditioning any new merger on the enhancement of competition, then it also ought to warrant across-the-board competition-enhancing actions—in particular, revision of the competitive access rules and the bottleneck rate challenge procedures—outside of the merger context. The new merger rules were adopted to address a scenario in which the industry would be moving toward two transcontinental systems. Absent any new major mergers, I believe that it would be difficult to defend actions reversing the longstanding competitive access rules or the more recent bottleneck procedures—both of which have been judicially affirmed—essentially to provide for two rail competitors upon request.

Rail Service. The merger integration process over the last few years has produced serious service disruptions. However, after significant efforts on the part of the rail carriers and extensive oversight by the Board, those service problems have been alleviated and rail operations overall are much improved. The performance metrics provided by the carriers show clear improvement, and the Board's Rail Consumer Assistance Program shows a steady decline in service issues brought to us for informal resolution. The 15-month merger moratorium imposed by the Board has ensured that the railroads have focused on running better the businesses that they now have in place without the distraction of more mergers.

Rail Line Construction Cases

The market, through new construction activities, is directing where new competitive services will be introduced. In addition to the build-outs initiated as a result of the Board's UP/SP merger conditions that I referenced earlier, during the past few years, railroads have pursued several new construction cases. The largest, and most controversial, has been the case involving the application of the Dakota, Minnesota and Eastern Railroad to extend its coal-hauling capability into the Powder River Basin, which the Board approved earlier this year with substantial environmental mitigation conditions, and which is now in court. The Board has also approved, or is in the process of reviewing, several other rail construction cases geared to produce new competition where the market will support it. While these projects are typically supported by shippers, they are often opposed by local groups with concerns about environmental and community impacts. The Board must balance these concerns against the transportation benefits that the new projects are designed to produce in resolving these matters in a timely and judicially defensible manner.

The Rail Sector Today

The last few years have presented many challenges for the rail sector, and the Board has likewise been challenged. However, I do believe that good progress has been made in meeting these challenges. Service overall is much better and more customer-focused; the railroads are stronger operationally; and there is much more constructive commercial communication among the various segments of the rail sector.

And the Board has done its part. It has brought parties together informally to resolve their differences in a way that ensures that rail service is more responsive to the needs of the customers. And it has moved cases before it to resolution as expeditiously and effectively as possible.

[3] I appeared before this Committee in the Spring of 2000 to discuss the moratorium and the merger policy rulemaking.

Of course, there is always more work to be done. The industry must continue to strive to be a customer-focused industry that can remain a vital part of our Nation's transportation system. And the Board must continue its efforts toward that end, working formally and informally to resolve disputes in a timely and effective manner. While I know concerns still remain, we must work to ensure that the progress that has been made will be sustainable into the future.

Senator BREAUX. Thank you very much, Ms. Morgan.

Let me recognize Senator Smith.

STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON

Senator SMITH. Thank you, Mr. Chairman. You and I are in and out of the floor right now, and I wanted to thank——

Senator BREAUX. I would rather keep you here.

Senator SMITH. Yes, I know that. We are on opposite sides of this issue.

But Ms. Morgan, thank you so much for your testimony and your service, and Mr. Chairman, I would like to include a more lengthy statement for the record, and I particularly wanted to welcome Dennis Williams, who is the manager of transportation services for Roseburg Forest Products, who has come to testify at this hearing at my request, and I appreciate that, and I am anxious to hear from as many witnesses as I am able.

Thank you, sir.

[The prepared statement of Senator Smith follows:]

PREPARED STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON

Thank you Mr. Chairman. In my capacity as Subcommittee Chairman last year, I began a series of hearings covering a wide range of rail transportation issues. I established such a hearing agenda because I believed at the time, as I still do, that given the complexity of rail transportation issues, our Members would benefit greatly through a series of hearings dedicated to rail issues. While the first two hearings in the series, focusing on actions taken by the Surface Transportation Board (STB) and the state of the rail industry were held in the spring of 2001, the shipper hearing was delayed by the events and aftermath of the September 11th terrorist attacks. I am pleased that Chairman Breaux has remained committed to holding this hearing to receive the shipper perspective on railroad issues.

Oregon is fortunate to be served by two Class I freight railroads, 19 shortlines, and Amtrak. One of my concerns about the rail industry is that the carriers—particularly shortline and regional railroads—are not earning enough to properly maintain their track and equipment. As we all know, railroads are extremely capital intensive. To assist smaller railroads, I have sponsored legislation with Senator Breaux (S. 1220) to establish a capital grant program to rehabilitate and improve the track infrastructure of Class II and III railroads, including projects to handle 286,000-pound railcars. The bill authorizes grants of $350 million in each of fiscal years 2003 through 2005. S.1220 was reported out of Committee on April 18.

Another concern I have is the quality of rail service. Like the rest of the country, Oregon shippers suffered through the service disruptions of the Union Pacific—Southern Pacific and the ripple effects of the Conrail integration. I will be very interested in hearing from Mr. Snow and from the shippers about what the industry is doing to improve service reliability, car availability, customer service, and ease of doing business.

As I stated when I initiated this series of hearings, their purpose is to gather information about the many complex rail issues involving rates and service. My goal is to try to find common ground on some of the problems and collectively develop reasonable solutions to those problems, whether through "a meeting of the minds" or perhaps through legislation. I believe that the only way legislation is going to be advanced is if a consensus product—one that is acceptable to both shippers and industry.

I would like to take this opportunity to welcome Dennis Williams, Manager of Transportation Services for Roseburg Forest Products, who will be testifying on the shipper panel. Roseburg is a large manufacturer and distributor of forest products headquartered in Oregon that relies heavily on rail to move its products to market. I am very interested in Mr. Williams' comments about his company's experience with rates and service under the Staggers Act and the impact of recent mergers on rates and service.

Senator BREAUX. Thank you, Senator.

Senator Rockefeller, questions, comments?

Senator DORGAN.

Senator DORGAN. Yes. Commissioner Morgan, let me ask about these nine complaints. Gosh, you know, I can find nine complaints in the morning about rail rates, so what is it that prevents complaints from coming to your office? Nine complaints is in my judgment rather minuscule. It is too costly, too cumbersome, too time-consuming, too much of an expectation that nothing is going to happen anyway? Tell me why we see a period, in which you describe, in which only nine complaints have been filed.

Ms. MORGAN. Well, obviously, I am not sure what the answer to that is. I can certainly speculate. I do feel, though, that nine complaints is a significant number relative to where we have been in the past, and it may be that because the board did move cases to resolution, and did set some guidelines and send some messages, people then have decided that the process does work, and they are prepared to pursue it further, so I do not see nine cases as indicating that there is no interest. I see that as an indication that they have a process out there now that they believe is in place, and is working, and they are prepared to pursue it.

Now, having said that, I——

Senator DORGAN. What does it cost to file a complaint?

Ms. MORGAN. The filing fee for a larger rate complaint, and we have had this discussion before, is $60,000 for a filing of a large rate complaint, and $6,000 for a small rate complaint, and again, you know my position on user fees in general, but we do not need to go there.

Senator DORGAN. Right. I mean, my point is that I think I could find 20 people in Stark County, North Dakota this morning that would like to file a complaint. I do not know that all 20, or any of the 20, would have $6,000 to spend to file a complaint, but I do not view nine complaints as encouraging. I mean, I view that you have received only nine complaints as inhibiting the process, and I suspect it is because of fees. I expect it is also because people think it is fruitless. For decades, filing a complaint with respect to rail rates is a sort of empty activity.

Has the small rate complaint process been used at this point?

Ms. MORGAN. No. As we have discussed previously——

Senator DORGAN. So the nine are all large rate cases, and they are submitted with the filing fees?

Ms. MORGAN. Yes.

Senator DORGAN. Tell me why you think the small rate complaint process is unused.

Ms. MORGAN. I am speculating now that the perception is that even the simplified guidelines that we have in place are simply too complex and too burdensome, which is why I collected a record about which I have communicated to the Hill regarding mandatory arbitration.

Senator DORGAN. Let me just try to summarize this. Do you not agree, then, that if there are no complaints being filed under the small rate complaint process, that should not be interpreted that small shippers out there are delighted with rail rates? Would you not expect that there are a lot of complaints out there, but small shippers do not have the wherewithal to put down $6,000 so that they can make that complaint with you, and the process therefore is broken and it needs fixing?

Ms. MORGAN. I have no reason to disagree with your assessment, so that may very well be the case, yes.

Senator DORGAN. Looking from your vantage point, if it is that patently obvious that a small shipper really has no chance out there at this point, the deck is stacked against them, they cannot even afford to file a complaint in most cases, why do you think we are unable to get legislation passed?

I am asking you that as an observer. You watch this from the Commission. In fact, you have testified that you would like legislation. You would like additional authority. You would like to streamline the process. What impedes that, in your judgment, in public policy?

Ms. MORGAN. Well, with respect to all of the pieces of legislation, and I certainly do not want to pick and choose among them, and put value on them, but I think it is important to make sure that we focus on the real issues and then try to address the real issues. A lot of the legislation that is out there is not just focused on the process, it is also focused on the fundamental policy of the statute, and those are clearly two different approaches, and they raise different issues, and they raise different controversies, so I think the question from a strategic perspective is, if there is a particular concern with small rate cases and addressing that, then perhaps that is the focus that should be pursued. Other issues that are perhaps more controversial might not be in that mix, but you know, this is not my business. This is certainly your business.

Senator DORGAN. But now, since this is likely your last appearance, as you leave, there is nothing at all wrong with your sticking your nose in our business here and saying things that could get you in trouble. What trouble can you get into at this point on your way out?

Ms. MORGAN. I have already been in so much trouble.

[Laughter.]

Senator DORGAN. Yes, so let me ask you this. You, either because of the adjudication of rate cases, or the lack of adjudication, or the lack of filing among small rate complaints, you know about rail rates. You know about rail rates because you work in these areas. If you were not in your current position, but instead were a farmer, and you know what I have told you about rates, you are a chemical company, you are hauling coal, or any one of a dozen other circumstances, do you think that you would be pounding on the table demanding that Congress do something about rates that are fundamentally unfair, or do you think, gee, things are just swimming, things are really going along well, and let us not do anything to rock the boat?

Ms. MORGAN. Well, obviously if people have concerns out there, that means that things are not perfect, and my view is always, if someone has a concern, we need to try to address it. The question really is how you address it, and I think what I have said in the past is that I do have concerns about legislation that would in essence result in two rail competitors at all points upon request, because I do think that long term the risk of that is yes, while rates will come down in the short term, the system will look very different long term because the financial needs of retaining the system will not be met.

Having said that, I think the issue of moving cases along and addressing the process, and making the process work better, is something that I have tried to do as Chairman, and I do not want to spend a lot of time on that, because you and I have had that discussion, but I did arrive at an agency with a huge backlog, and I have attempted to address that backlog and attempted, within the confines of my process, to work through that backlog.

I think the small shipper case issue is one of concern, and that is why I have communicated with this Committee on a number of occasions about alternative legislative approaches that you could take to that, but I will say on the broader issue of providing for two competitors upon request, I do have a concern about that.

Senator DORGAN. My time is up. I would love to talk to you about that at great length, but let me just say this. The financial interest that you describe—financial interest, you were talking about keeping railroads solvent and so on. There are competing financial interests, as you know. The fellow that drove 16,000 miles with an 18-wheeler to put wheat on a railroad that then ran it back through his yard on the way to the West Coast, he also has financial interests. Those are the financial interests, in my judgment, that are not very well represented in the considerations both in Congress, and also in the considerations by regulatory agencies.

Senator BREAUX. Thank you, Senator. Senator Allen.

Senator ALLEN. Just a brief overview from Ms. Morgan. What have been the facts, and I hope you have the facts, of the effect on actual, rail rates since the passage of the Staggers Act?

Ms. MORGAN. Well, we have done studies, but also the General Accounting Office has done similar studies, and we have arrived at essentially the same conclusion, which is that rates overall have declined since passage of the Staggers Act.

Now, having said that, there are certain rates which have either not declined, or have increased, and there are certain movements where that has occurred, and that, of course, is a dynamic of differential pricing that occurs in the rail sector, but overall, if you look at the graphs for various sectors of the shipping community, you will see rates in a steady downward trend.

Senator ALLEN. All right, and so you are saying the rail rates overall, while some few may be up, overall—and some may have actually stayed relatively the same, and I assume that these rate figures are based on calculating inflation and so forth.

Ms. MORGAN. Yes.

Senator ALLEN. But overall, you are saying rates are less now for shipping by rail than they were in 1980.

Ms. MORGAN. That is correct.

Senator ALLEN. Could you say the same as far as other modes of transportation? I know you are the Surface Transportation Board.

Ms. MORGAN. I would not really want to speak to that. I might speculate, but I think I am in enough trouble already, so I will stay away from the other modes.

Senator ALLEN. OK. Do you have a percentage of how much the reduction in rates has been since 1980, as far as rail?

Ms. MORGAN. Well, we have the figures that show up to a 40-percent reduction overall in rates.

Senator ALLEN. So overall there has been a 40-percent reduction in rail rates since 1980. Thank you. I have no further questions, Mr. Chairman.

Senator BREAUX. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Chairman Morgan, the GAO study that you refer to, of course, obfuscates, and therefore I think eliminates the argument that you answered in terms of Senator Allen's question. The GAO did not compare rates charged to specific shippers. It did not do that. It relied on something called the average revenue per ton mile calculation, that obscures the competitive circumstances of individual shippers, so you know, it has gone down for some, it has gone enormously up for others.

You expressed concern, I was very interested by that term, about small shippers and other shippers. My interest is much greater than a general concern. You talked about increasing the action on the backlog. Well, that is only the people who are there, and you have had 20 cases in your 8 years that have come before you. I would guess there is probably several thousand out there, because for large shippers even, it has gone from $54,000 to $61,000 just to get before you, to try to get before you. All the discouraged people cannot possibly be counted.

As you know, you have always said that you think the STB lacks the authority to do what I and others would like to see done. My own view, being very frank, is that I think that the STB has really looked more at the profitability of railroads than at your so-called concern about shippers. You have done nine things, and that is good, but you know, that is not much in 8 years, from my point of view. So let me ask you a couple of hypothetical questions, and the Chairman will cut me off when my time is over.

Assume that your view as to the extent of the STB's authority is absolutely the correct one, and I am all wet. Given the extent of shipper discontent that Senator Dorgan and others who might be here, you now have a successor who has been appointed. We have not had a hearing for that person yet. Assuming that discontent, and taking your word, concern, very seriously, what is it that you would advise your successor to pursue to lessen the concerns and to increase competition? In fact, what will you, because you will talk with him.

Ms. MORGAN. Yes, I will talk with him.

I think in terms of the board activities, I would suggest that he continue—and I know you do not put much value in this, but that he continue to focus on moving the cases that we have in the building to resolution, because I do feel very strongly that the more cases are resolved, the more people understand the process and will avail themselves of the process if that seems to be the appropriate thing to do, but I realize you and I do not agree on that, but that is what I would tell him.

I would also tell him that as concerns are raised, as the board has done, not to the extent that you would have liked us to have done it, make sure that you do look at the law, and do try to apply the law in a way that does address the concerns, and again, we have done that, not to the extent that you would have liked, but I think we have moved issues in a direction to address the concerns that have been raised.

Senator ROCKEFELLER. OK. That makes it a little harder for me to follow up, because there is nothing specific there. I mean, you speculated that probably Senator Dorgan was not incorrect about all those people lined up out there.

Now, if you have got a civil rights case, you get to bring it. If you have got any other kind of case, you get to bring it. Somehow these people never get to bring it, partly because the Association of American Railroads is the most powerful lobby in Washington. It operates under the radar. It does all of its work so nobody can see, and it appears to have a friendly Surface Transportation Board. So your concern, I take it, therefore is not translated into any specific recommendations to your successor, other than to continue focusing on those cases which are before you. Not necessarily doing anything to make it easier for people who legitimately could appear before you to be able to do so.

If I were in your position, I would be sleepless at nights worrying about that type of thing.

Ms. MORGAN. Well, you might be surprised that I do have sleepless nights. I care about this as much as you do, and I do try to resolve these matters in a way that I feel is appropriate.

I do think that, again, moving the docket forward is not an insignificant issue, because I think part of what has gone on in some areas at the board, and before at the commission, was that there were areas that were just left without attention, and I think that what we have tried to do is to give those areas attention, set the guidelines, make the substantive decisions. I discussed that in my oral presentation. I think that is important, and I think the head of that agency should continue to pursue that approach, and I think that is not general, it is very specific.

Senator ROCKEFELLER. Your successor would concern himself only with those cases which have in fact made it to you, and not concern himself with all the hundreds, thousands of cases which have not been able to afford, have given up, been discouraged, peer-pressured or whatever, not to bring their cases before you. Those do not matter so much. The cases before you do matter. That is what you would ask him to focus on?

Ms. MORGAN. I think that by resolving what is before us, we are indicating that we care about what is before us and what is not yet before us, because by resolving what is before us, we help those who are not before us to decide whether they want to move forward.

Now, with respect to user——

Senator ROCKEFELLER. I do not think that is the case. My time is up. I really do find that answer extraordinary. Is it a matter of cost? Is it a matter that we are not going to get anywhere? They have only got a few cases before them that usually work out the wrong way, they take forever to decide, surely you understand that it takes a lot more than just if you do your 14 or 20 cases that you are working on. Some of them get resolved in the favor of shippers. Somehow it is going to take all this body out there and encourage them to exercise their due grievance.

Senator BREAUX. Thank you, Senator.

Senator Smith.

Senator SMITH. Thank you, Mr. Chairman, and Ms. Morgan, I began my earlier comments by thanking you for your service. I did so because I see you having to play a very difficult role, and perhaps the role of Solomon in trying to settle these differences.

I hear often the plight, the plea, the frustration of captive shippers and their seeking of relief. I also look at the balance sheets of the railroads, and I do not see them exactly swimming in it either, and I am very worried that the amount of reinvestment in our rails in this country is falling behind, and I am also mindful that the gap between the cost of capital and return on investments in railroads has closed, but certainly there is still a considerable gap existing, so the probability is that we will continue to underinvest in our rail infrastructure in this country.

I would like to ask you, as the railroads have closed this gap on the cost of capital and return on investment, in your opinion, how have they done it? Have they done it through rate increases? Have they done it through cost containment? Have they done it through rate improvements in the Staggers Act? What accounts for that? How have they done it?

Ms. MORGAN. Well, I think, depending upon which period of time we have been in, I think it has been a combination of a lot of different efforts. I think that since 1980 the railroads have streamlined their network, have cut costs, have become more productive, have learned how to invest in a smarter way in their infrastructure and, of course, the Staggers Act allowed that sort of freedom, and so I think it has been a progression of a lot of different activities.

I think what we see right now is that a lot of what I have termed the big silver bullets, the big areas where you could reduce costs and so forth, well, we do not have that any more, so what the carriers are faced with now is really I guess what I would call blocking and tackling, a very surgical effort to go into all aspects of their operations, and continue to become more and more efficient, continue to streamline the cost, and also look very carefully at the service that is being provided, making sure that the investment is smart in connection with the service, and that the pricing reflects the service being provided.

Senator SMITH. Do you think our investment as a Nation is sufficient in the rail infrastructure?

Ms. MORGAN. Well, the freight rail infrastructure, of course, is privately invested in, so——

Senator SMITH. But nevertheless has a real impact on our roads, and the amount of wear and tear there, and the amount of congestion. You know, how do you view the health of our rail infrastructure?

Ms. MORGAN. Well, I think we need to continue to pay special attention to it. I think the concern that you have expressed is one that we need to all have in our minds, because it is a privately invested-in infrastructure, and the freight rail network is important to the transportation system, and if we want to make sure that it continues in the private sector, we need to make sure that the policies that we have in place encourage the kind of continued infrastructure——

Senator SMITH. Are there any policies that we have in place that we ought to change to facilitate that?

Ms. MORGAN. Well, in terms of the regulatory policies, certainly——

Senator SMITH. Or taxes?

Ms. MORGAN. Well, taxes are not my particular area of expertise, although I know that there is discussion of some sort of incentives that would encourage continued investment. There is also discussion of specific funding for particular transportation projects that might involve railroads.

In terms of regulatory philosophy and policy, I think that we need to make sure that we continue to have a policy in place that provides the kind of revenue flow that allows for continued infrastructure investment.

Senator SMITH. Thank you, Mr. Chairman.

Senator BREAUX. Thank you.

Madam Chairman, what does the average time for a rate case on challenging the reasonableness of the rate take on average, from the time it is filed to the time it is completed by the STB?

Ms. MORGAN. Well, of the cases that we have resolved, it has taken anywhere from 1½ years to 3 years. Now, we have nine pending, as I indicated to you. Some are further along than others. We have some that are in the early stages of discovery. The one case that I mentioned that has some complexities to it is still in its early stage, so that has been with us——

Senator BREAUX. Okay, 1½ to 3 years, and I am told by some of the shippers who have participated in this, and I am sure from the railroad's perspective as well, you are generally talking about hundreds of thousands, if not millions of dollars in legal fees and consulting fees and economic studies, and all of these things that go into one single rate case. Is there not a better way, a better process that could be set up?

Some have suggested the concept of arbitration, where you bring in the shipper and you bring in the railroads before the STB and you say, look fellows, can you all get together? We are spending up to 3 years to determine these cases, and like Senator Dorgan said, I am sure for every one case that is brought there are probably 100,000 complaints that cannot get brought, because they do not have the legal-financial wherewithal to do it.

It seems like the process is just so time-consuming, so complicated, so technical that some have suggested some type of arbitration procedure may be a lot faster and quicker if just people could say, look, you folks come up with a solution to this, and if you do not, there are going to be penalties.

Ms. MORGAN. Well, of course, right now parties can voluntarily go to arbitration under our procedures.

Senator BREAUX. Does the STB have the authority to order arbitration?

Ms. MORGAN. No. Mandatory arbitration would require legislation.

Senator BREAUX. Would that be a good thing from your outgoing Chairman's perspective, now that you are free to speak your thoughts, that you would have the authority to say, look, this case should not take 3 years, I am going to appoint an arbitration panel and tell them in 30 days, or 60 days, to settle it?

Ms. MORGAN. Well, I feel that many of these cases should be handled in more of a private sector situation anyway, and we have arbitration in the private sector for certain cases involving the National Grain and Feed Association and the smaller railroads and the larger railroads, so I think arbitration is something that needs to be looked at carefully in the context of resolving these cases.

Senator BREAUX. Could it be helpful?

Ms. MORGAN. I think, you know, anything can be helpful, because obviously I hear people's concern here about how long these cases take. You know, we can get as frustrated as you do about how long they take. As with any litigation, once it gets into a litigious situation, then, of course, the due process kicks in, and then it takes time. Arbitration is certainly a way around that.

Now, I will say that there are parties out there that do not have a consensus on what should be arbitrated and what should not be. When I instituted this proceeding for arbitration on smaller rate cases, there was not even consensus there as to what type of case should be covered, where the cutoff would be, whether it would be appealable, and so forth, so there were a lot of issues associated with arbitration, and then there was concern raised about, if a case has great financial impact, and it is arbitrated, does that decision somehow set some sort of precedent for future cases, and then you of course get back into the whole policy in the Staggers Act of balancing the needs of the shippers with the financial health of the industry.

Senator BREAUX. Well, I think it is something that we should at least consider.

The only other question I have is on the bottleneck rate cases. Currently, as I understand it, a railroad must quote a bottleneck rate only if there is a contract for that portion of the line that is not part of the bottleneck. It would seem to me, that sometimes from a shipper's perspective, there is a hesitancy on other railroads to compete on the non-bottleneck portion of the shipping lane.

Is it not possible, just to look, without having a contract, just look at the bottleneck section and ask the railroads what is the charge for that portion, without having to show the shipper that there is a contract on the non-bottleneck sector? If the complaint is on the bottleneck section only, why do we require a shipper to show that there is a contract on the non-bottleneck section before we can find out what is being charged for the bottleneck portion?

Ms. MORGAN. Well, first of all let me say that, with respect to bottlenecks, we have had four cases under our new policy, which is that if you have a contract with the non-bottleneck carrier, then you can seek a bottleneck rate.

Senator BREAUX. Which is very difficult sometimes to get.

Ms. MORGAN. But we have had four cases, so that reflects that there is some activity out there in response to our policy.

Now, with respect to the other, to the broader question, a full movement that involves a bottleneck and a non-bottleneck has a cost associated with it, and it is very possible that the rate for the non-bottleneck segment is a competitive rate, and a lower rate, combined with the bottleneck rate, which may be a little higher, makes sure that the revenues coming in for that entire movement cover the costs associated with that entire line.

The concern is that if you go in and review each and every bottleneck rate, that bottleneck rates will come down. Then the combination of the lowered bottleneck rate and the non-bottleneck rate is not enough revenue to cover the costs associated with maintaining that line.

Senator BREAUX. Well, we are going to hear from the shippers, who have some specific concerns about that requirement.

Madam Chairman, thank you very much. Thank you for your service, and I look forward to continuing to work with you.

Do you have another question? Senator Rockefeller has one other question.

Senator ROCKEFELLER. Chairman Morgan, would you agree or disagree with any of the following statements:

Shippers have been forced to buy their own rail cars and both their related capital and maintenance costs.

Ms. MORGAN. I agree that that is out there. I do not know, you know, what it is with each and every shipper, but yes, shippers do have shipper-owned cars.

Senator ROCKEFELLER. Fundamentally, you agree?

Ms. MORGAN. Yes, that is out there.

Senator ROCKEFELLER. OK. Shippers have been required to spend millions to improve loading facilities to qualify for a railroad's bulk rates. Agree or disagree.

Ms. MORGAN. I think that is out there, yes.

Senator ROCKEFELLER. Shippers have been forced to pay for intermodal hauls on highways to take advantage of better rates at centralized bulk loading facilities. Agree or disagree.

Ms. MORGAN. No particular example of that has been brought to my attention. The examples of the others have, but I have no reason to disagree with you.

Senator ROCKEFELLER. Shippers have been forced to pay increased rates to third-party cargo facilities, demurrage fees, with no improvements in service. Agree or disagree.

Ms. MORGAN. Well, I have heard that claim. Whether that is true or not, I cannot tell you. I have received some letters on that, yes. I have not investigated to see if that is actually, with no improved service whether that is actually going on or not, but I have had letters indicating that demurrage rates have gone up, yes.

Senator ROCKEFELLER. Well, I think I will kind of leave it at that, Mr. Chairman, except that I have a letter from the President and Chief Operating Officer of Bayer, Incorporated, and I want to make this letter a part of the record, and in the letter he says the

STB is the only agency, that is for the chemical industry, with authority over complaints about unreasonable service and rates. Bringing a complaint before the STB can cost between $500,000 and $3 million as a larger shipper obviously. And may take, as he says, as long as 16 years to resolve, and the man is experienced and presumably had counsel helping him in writing this letter. Many companies obviously find these costs prohibitive and rarely productive.

[The information referred to follows:]

BAYER CORPORATION
Pittsburgh, PA

Hon. JOHN D. ROCKEFELLER IV,
531 Hart Senate Office Building,
Washington, DC.

Dear Senator Rockefeller:

Although we have not had the pleasure of meeting, I hope to rectify that by visiting your office in September. As you know, Helge Wehmeier's retirement was effective July 1, and I have assumed the mantle of President and Chief Executive Officer of Bayer Corporation.

I have been informed that Senator John Breaux, Chairman of the Surface Transportation and Merchant Marine Subcommittee of the Senate Commerce Committee, will be holding a hearing on July 31 to hear views of shippers and railroads on the current state of rail competition.

Bayer Corporation, which has more than 23,000 employees and sales of $10.1 billion in the year 2001, is a major producer of basic chemicals including Isocyanates, Polyols, Prepolymers and Plastics Resins. Bayer has major chemical plants in Ohio, Texas and West Virginia.

At Bayer Corporation the rail mode of transportation is very important to our chemical business. Bayer supports legislation, which would promote effective rail competition. We believe that effective rail competition can be achieved only by legislation which will result in service by at least two competing railroads at all shipping and receiving sites.

We greatly appreciate your leadership, Senator, for introducing the bill, which provides up to 35 billion dollars in loans and loan guarantees for infrastructure, improvements, and enables companies to construct rail spur "build-outs" in order to obtain competition. We commend the Senate Commerce, Science, and Transportation Committee for adopting your amendments and passing S1991.

Competition brings strength to global and domestic markets in all lines of business. We know that a healthy dose of competition will do the same for railroads. Indeed, the Burlington Northern/Santa Fe (BNSF) communicated to the Surface Transportation Board (STB) that, "only the introduction of an independent second competitor can ensure continued, genuine competition." Bayer Corporation fully supports that statement.

Only four major railroads now serve the industry; namely, Union Pacific, Burlington Northern, Norfolk Southern, and CSXT. Of these railroads, CSXT has consistently opposed legislation which would permit competitive access under which shippers and receivers of rail freight, now served by only one railroad, would have the option to seek the services of a second railroad by use of the first railroad's facilities on a reasonable basis.

Our nation needs and deserves improvements in competitive access and service reliability, so that products can be delivered efficiently all around the world. These conditions are necessary, if we are to successfully compete in a global economy.

The Staggers Rail Act, passed in 1980, was intended to deregulate the nation's railroads, encourage competition, protect captive shippers from unreasonable rates and return the railroads to financial health. During the 22 years since enactment, the Surface Transportation Board (STB) has concentrated on the health of the railroads but has not focused on the pro-competitive provisions of the Staggers Act.

As everyone knows, "captive shippers" are the "cash cows" of the railroad industry. Railroad customers who believe their rates are exorbitant can appeal to the Surface Transportation Board (STB). The STB is the only agency with authority over complaints about unreasonable service and rates. Bringing a complaint before the STB can cost between $500,000 and $3 million and may take as long as 16 years to resolve. Many companies, obviously, find these costs prohibitive, and rarely productive. Therefore, from Bayer Corporation's perspective, the current SIB complaint system and procedures are greatly in need of reform.

At Bayer Corporation we have seen first hand what competition will do with direct rail-to-rail competition. At our Baytown, TX, plant site, we received, as part of the Union Pacific-Southern Pacific (UP–SP) merger, competitive access at that plant. We have seen improvements in both cost and service at that location because there are now two railroads, namely Union Pacific and BNSF, competing for our business. Better service and lower costs would not have happened without competition. We have seen our rail rate levels drop from 20 to 50 percent depending on the movement. It is no coincidence that Bayer chose to make its largest ever investment of $1.3 billion, at Baytown, TX.

In 2000, Bayer Corporation acquired Lyondell's Polyol business, which includes a manufacturing unit at the South Charleston, WV, site. This location is "open" to both the CSXT and Norfolk Southern railroads. When comparing rates for that site to our New Martinsville, WV plant, which produces the same basic product, but is "captive" to CSXT, the rates are significantly higher—this fact clearly illustrates the need for competitive access.

Bayer competes with numerous other producers of chemicals and welcomes that competition. We cannot expect the law to shield our business from competition, as is the case for the railroads. We simply ask that there be a level playing field under which no shipper is captive to a single railroad. Rather, each shipper should have available to it, the service of at least two railroads, so that all shippers may have equal access to competitive rail rates. There is no logic in a situation where two of our major shipping sites, namely Baytown, TX, and South Charleston, WV, should have two railroads competing for business, while our plant at New Martinsville, WV is captive to a single railroad. The enactment of competitive access legislation should assist in providing a level playing field for rail transportation, and permit shippers and receivers to compete on the basis of quality and service of their product, rather than on the existence or non-existence of rail competition.

Let me close by thanking you again, Senators for tireless support of principles and goals cherished by Bayer Corporation, on rail competition and many other issues.

Sincerely,

DR. ATTILA MOLNAR,
President and Chief Executive Officer,
Bayer Corporation.

Senator ROCKEFELLER. So I would say a bittersweet goodbye to you, if you do not come back to testify again. I think you are a smart person and a really good person. I just wonder about the whole concept of working on the relatively few cases that you have before you, versus the knowledge of all those other cases that cannot afford to come before you or get discouraged to come before you, who are real people doing real business, trying to really help America prosper, and their families, and have no attention paid to them.

Ms. MORGAN. May I just——

Senator ROCKEFELLER. Please.

Ms. MORGAN. Two things. User fees, because I started to get into that, but your time was up. I have had this discussion before on user fees. User fees are not my idea. If someone wanted to eliminate user fees entirely, that would be just fine. That is not something that I have necessarily embraced. It has just been around, and it is a policy in the Government, so I leave that issue to you.

The second point is, the case that took 16 years, we have had this conversation before. That is McCarty Farms. Yes, that was around for 16 years. It was there when I got to the commission. I made it a top priority to resolve that case. There is no case in my building that has been around for 16 years, so as I move on here, I want to make that perfectly clear. That was a case that was around before I got there, and I stepped up to the plate and resolved it, even though it was the one case that the shippers did not prevail on.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Senator BREAUX. Thank you, Ms. Morgan. I would like to welcome up our panel next consisting of Mr. John Snow, who is Chairman and President and CEO of CSX Corporation, Mr. Terry Huval from my State, representing the Lafayette Utilities System, Mr. Mark Schwirtz, who is Senior Vice President and Chief Operating Officer of the Arizona Electric Power Cooperative, Mr. Charles Platz, who is president of Basell North America, Incorporated, Mr. Steve Strege, who is Executive Vice President of the North Dakota Grain Dealers Association, Mr. Dennis Williams, manager of transportation services, Roseburg Forest Products.

Gentlemen, welcome to the Committee. I thought that what we would do would allow Mr. Snow to testify last. We will allow the shippers to present their testimony and present their concerns, and then hopefully some of those concerns will be able to be addressed by Mr. Snow when he presents his testimony.

So we will start, not with Mr. Huval, because I would like to be here when you testify. Let me start with Mr. Mark Schwirtz. Mark, if you would go ahead and go first, representing the Arizona Power Company.

STATEMENT OF MARK W. SCHWIRTZ, SENIOR VICE PRESIDENT AND CHIEF OPERATING OFFICER, ARIZONA ELECTRIC POWER COOPERATIVE, INC.

Mr. SCHWIRTZ. Thank you, Mr. Chairman, Members of the Subcommittee. My name is Mark Schwirtz. I am the Senior Vice President of Arizona Electric Power Cooperative, Inc.——

Senator ROCKEFELLER. (presiding) Please proceed.

Mr. SCHWIRTZ.—or AEPCO, and we are located in Southeast Arizona, primarily in Benson, Arizona, and AEPCO greatly appreciates the opportunity to be here today.

I would like to introduce, or at least acknowledge our CEO who is here today because of the importance of this issue, and I also brought my daughter along with me for support and to witness Government at work. They are in the audience.

AEPCO is a nonprofit rural electric cooperative. We serve our members, located primarily in rural, economically disadvantaged areas, on a cost pass-through basis. AEPCO generates the majority of its power by burning coal. Coal transportation and its procurement constitutes our largest single expense. Because AEPCO is a classic captive coal shipper, as we have heard about today, our rail rates are very high and flow directly into the rates our members pay.

Our experience illustrates both the need for effective rate regulation, and the shortcomings in the regulatory process at the Surface Transportation Board. However, before explaining our own frustrations, I would like to note our deepest respect for Chairwoman Morgan and the dedication she has displayed in her service on the board. We also believe that much of the board's difficulties flow from the lack of resources to meet its substantial challenges.

Unfortunately, AEPCO has been here before. During the seventies and eighties, AEPCO pursued a rate case against its carriers before the Interstate Commerce Commission. That case lasted over 10 years, during which our efforts to obtain relief were repeatedly blocked. Only after the Ninth Circuit likened our case to the interminable Jarndyce *v.* Jarndyce litigation in Charles Dickens' Bleak House and found that we, which I think this is important, suffered the arcane rigors of the regulatory process long enough, and only after Congress expressed its own concerns, was AEPCO able to achieve reasonable rates.

Unfortunately, the rates achieved merely 15 years ago have been of fleeting value. Railroad costs have fallen substantially since then, as we have heard. While average rail rates have also supposedly declined, ours have risen continuously, and no longer bear any reasonable relationship to the railroad's cost of service.

Accordingly, on December 29, 2000, AEPCO filed a new rate case with the board. This is the one Chairwoman Morgan was talking about. We first challenged only the rates for New Mexico coal. However, in response to railroad discovery, AEPCO amended its complaint to include rates from other origins. The railroads cancelled some of those other rates, refused to ship coal we had bought, moved to dismiss part of our complaint, and refused to comply with discovery. Major delay has resulted, even after the board has issued a decision on December 31st, 2001. Additional pleadings have since been filed, but the board has not ruled. AEPCO's case continues to wallow in discovery and motions.

The delay harms our coal procurement activities. We do not know what our rates will be and if we will even have rates from different origins in the West. Determining our cheapest source of coal has become an exercise in uncertainty. The uncertainty prevents us from making long term commitments and impairs our negotiations with coal suppliers. Under the board's regulations and governing statute, rate cases are to be decided in 16 months. Our complaint has now been pending for over 19 months. No evidence has been filed, no procedural schedule exists. The board has said it will set one once discovery is completed, but discovery is stalled until the board rules on AEPCO's long-pending motions.

The ICC Termination Act of 1995 supposedly created the STB to remove some of the bureaucracy and streamline the process. This was effective in approving the recent Conrail merger, which took 13 months, but AEPCO has already been waiting 19 months, and expects to be here at least another year or more.

Unfortunately, we appear headed down the same regulatory path as 15 years ago. AEPCO urges this Committee to exercise oversight so that rate cases like AEPCO's are not forced to linger. One step is for the Committee to require the board to make a quarterly status report on rate cases and state if cases are on track and, if they are not, identify the cause of the delay and the actions taken to avoid further delay.

Also, the board should receive the resources it needs to do its job. Given the difficulties AEPCO has experienced, the time has come to set a long-term goal of finding a more efficient way to achieve reasonable rates for captive shippers, for example, pro-competitive legislation, and a short-term goal that corrects the regulatory bottleneck that shippers face at the STB.

I again thank you for the opportunity to bring our concerns before you, and respectfully request that my written statement be included in the record. Thank you.

[The prepared statement of Mr. Schwirtz follows:]

PREPARED STATEMENT OF MARK W. SCHWIRTZ, SENIOR VICE PRESIDENT, AND CHIEF OPERATING OFFICER, ARIZONA ELECTRIC POWER COOPERATIVE, INC.

My name is Mark W. Schwirtz. I am the Chief Operating Officer and Senior Vice President of Arizona Electric Power Cooperative, Inc. (or AEPCO), located in Benson, Arizona. AEPCO deeply appreciates the opportunity to appear before you today.

AEPCO is a nonprofit rural electric cooperative, financed in large part through the Rural Utilities Service of the Department of Agriculture. AEPCO serves its ratepayers, located primarily in rural, economically disadvantaged areas of Arizona, on a cost pass-through basis. AEPCO generates much of its power by burning coal at its Apache Generating Station in Cochise, Arizona. The cost of coal together with coal transportation constitutes our single largest expense. Because AEPCO is a classic "captive" coal shipper, the transportation rates that we pay our carriers, the Union Pacific and the Burlington Northern Santa Fe, are very high, and factor directly into our rates for electric power.

AEPCO's predicament vividly illustrates why captive shippers need to be protected from monopolistic, market-dominant carriers, and why this Committee must exercise diligent oversight over regulatory agencies that fall within its jurisdiction. Moreover, if, as now appears to be the case, regulatory agencies such as the Surface Transportation Board are unable to meet their statutory and regulatory duties, then more self-executing regulatory approaches, such as competitive access, should be implemented. In that regard, the legislative proposals that have already been introduced and assigned to this Committee merely call for the adoption of the sort of pro-competition approaches to other "natural" monopolies that have been adopted in a myriad of other industries.

From the late 1970's through the mid-1980's, AEPCO was engaged in a protracted rate case with the UP's and BNSF's predecessors before the Surface Transportation Board's predecessor, the Interstate Commerce Commission. That litigation lasted over ten years, during which our efforts to obtain a meaningful review of our carrier-imposed rates were repeatedly blocked. Only after the 9th Circuit, in *AEPCO* v. *United States*, 816 F.2d 1366, 1368 (9th Cir. 1987), likened our rate case to the interminable *Jarndyce* v. *Jarndyce* litigation in Charles Dickens's *Bleak House*, and found that AEPCO had "suffered the arcane rigors of the regulatory process long enough," and only after Congress expressed its concern about the situation, was AEPCO able to achieve a settlement that afforded its ratepayers a modicum of reasonable rail rates.

Unfortunately, the rates achieved nearly fifteen years ago have proven to be of fleeting value. Railroad costs have continued to fall very substantially since that time. While, as the railroads are quick to note, *average* rail rates, even for coal, have also declined, AEPCO has faced continuous railroad rate increases over that period. As a result, AEPCO's rail rates no longer bear any reasonable relationship to the railroads' costs of providing service.

Accordingly, on December 29, 2000, AEPCO filed a new rate case with the Board. AEPCO originally challenged BNSF's and UP's rates for moving coal to AEPCO's Apache power plant only from the New Mexico origins that have always been AEPCO's primary source of coal. However, the railroads quickly initiated discovery designed to demonstrate that AEPCO will likely need to obtain significant volumes of coal from other sources in the future. AEPCO then amended its complaint on March 9, 2001, to include rates from Colorado and Powder River Basin (or PRB) origins that BNSF and UP had previously established. AEPCO's objective in amending its complaint was to avoid the burden and inefficiencies of piecemeal litigation and obtain rates that covered all of its long-term coal supply options, including the PRB. The PRB is the nation's largest source of coal, and the coal is relatively low-priced and low in sulfur. AEPCO believed that including the additional origins in its rate case would make the litigation process as efficient as possible for all concerned, especially compared to bringing an additional rate case in a few years.

The railroads responded by doing everything in their power to frustrate AEPCO's rate case. In quick order, they withdrew their PRB rates, refused to move the PRB coal that AEPCO had bought, sought to dismiss the PRB rate challenge, attempted to consolidate AEPCO's rate case with those of three other shippers, refused to respond to discovery, and even initially refused to reestablish PRB rates as ordered by the Board. All of these actions served to delay AEPCO's rate case.

On December 31, 2001, over a year after AEPCO filed its original complaint, and over nine months after AEPCO amended its complaint, the Board finally denied the railroads' motion to dismiss the PRB rate challenge and addressed other discovery matters. However, the railroads promptly responded by refusing to produce the information AEPCO needs to proceed with its rate case, particularly regarding the PRB rates. The railroads even claimed that AEPCO needed to present separate evidence to challenge the Colorado and PRB rates. AEPCO has since filed additional motions to compel and has responded to other railroad motions, but the Board has not ruled on any of these pending matters. Indeed, both of AEPCO's motions to compel have been pending for longer than the 75 days that the Board's regulations provide are to be sufficient for completing all discovery. As a result of the Board's lack of action, AEPCO's rate case is, as of this moment, effectively dead in the water.

The lack of progress in our rate case and associated uncertainty creates major operational problems for us. As long as the litigation remains pending, we do not know what our railroad rates will be and, in the case of the PRB and some other origins, whether we will even have any rates at all. Since our rail rates are subject to change or possibly termination, efforts to develop our delivered cost of coal from different origins involve exercises in substantial uncertainty, which undermines our ability to make important coal procurement decisions, and also to fulfill our duty to provide power to our members and other customers at the lowest possible cost.

Moreover, AEPCO's experience has not been unique. Unfortunately, other western coal shippers have experienced very similar delays in their rate cases.

The intolerable delay cannot be reconciled with the Board's obligations. Under the Board's regulations (49 C.F.R. § 1111.8), the evidentiary filings in a rate case are to be completed within seven months of the filing of the complaint, and the governing statute (49 U.S.C. § 10704(c)(1)) specifies that rate cases should be decided within nine months of the completion of the evidentiary record. Hence, rate cases should be decided within sixteen months of filing. Moreover, the governing statute (49 U.S.C. § 10704(d)) further instructs the Board to "establish procedures to ensure expeditious handling of challenges to the reasonableness of railroad rates . . . includ[ing] measures for avoiding delay in the discovery and evidentiary phases of such proceedings . . . and for ensuring prompt disposition of motions."

These requirements have been completely disregarded in AEPCO's case. AEPCO's complaint has now been pending for over nineteen months, three more than the period in which cases are supposed to be decided. AEPCO's case has not been decided. In fact, not one page of evidence has been filed, and there is not even a procedural schedule. The Board has said that it will establish a procedural schedule once discovery is completed, but, so far, the railroads have been refused to respond to discovery on the PRB rates and other matters, even though their motion to dismiss the PRB rates was supposedly denied seven months ago.

AEPCO, like other shippers, viewed the passage of the ICC Termination Act of 1995 and the establishment of the Board as a sign that rate cases would receive the attention they deserve and would be decided on a reasonably prompt basis. At first, the Board seemed interested in fulfilling that objective. More recently, however, the Board has seemed more interested in other matters, such as mergers, and has allowed rate cases and captive shippers to suffer from apparent neglect. At this point, it is difficult for AEPCO to discern any meaningful difference between the Board and the Commission that the Ninth Circuit criticized in no uncertain terms fifteen years ago.

Accordingly, AEPCO urges this Committee to exercise its oversight function to ensure that the Board discharges its statutory and regulatory responsibilities in a timely manner. AEPCO would request that, as a minimum measure, the Committee require the Board to submit a quarterly report on the status of all pending rate cases, indicate whether the cases are "on track," and if the cases are not adhering to the required schedule, identify the source of delay, which litigant (or the Board) is responsible for the delay, and what measures, if any, the Board is taking to ensure that the case proceeds to a timely resolution. Such a reporting requirement could do much to help focus the Board's attention and facilitate this Committee's efforts to remain informed.

In addition, given the Board's current difficulties in fulfilling its regulatory responsibilities, it is also appropriate to consider changing the regulatory approach. In recent years, several "competitive access" bills have been introduced to substitute competition for substantive rate regulation. While the railroad industry is quick to characterize these proposals as "re-regulation," they are, in fact, deregulatory in nature, and are intended to subject so-called "natural" monopolies to the type of competition that is standard throughout the rest of the economy. These approaches may also require less in the way of regulatory resources. If the Board is not going to implement the rate regulation that currently exists, Congress should give serious consideration to these other types of proposals, which have been adopted in a myriad of other industries.

Again, on behalf of AEPCO, I thank you for the opportunity to bring our concerns before you.

Senator ROCKEFELLER. Thank you very much, sir, and Mr. Williams, you will be next.

STATEMENT OF DENNIS WILLIAMS, MANAGER OF TRANSPORTATION SERVICES, ROSEBURG FOREST PRODUCTS

Mr. WILLIAMS. Senator Rockefeller, I would like to thank Senators Breaux and Smith for inviting me to speak before your Subcommittee today on my experience in shipping via railroad. I have also prepared a more detailed summary that I wish to have entered into the record of this hearing.

My name is Dennis Williams, and I am the Manager of Transportation Services for Roseburg Forest Products Company, a major manufacturer and shipper of forest products, with headquarters in Dillard, Oregon, and facilities located in southwestern Oregon and northern California.

We have shipped each year approximately 5,000 carloads of inbound logs and veneer, and we ship outbound approximately 12,000 carloads each year of finished product to our customers located throughout the Nation and eastern Canada.

All of our facilities are located on the Central Oregon and Pacific Railroad, a 450-mile shortline that is contractually limited to interchanging traffic to the Union Pacific Railroad for its outlet into the mainstream railroads. Roseburg Forest Products is a captive shipper.

My career in industrial transportation management began more than 34 years ago. Thus, I am really familiar with the intricacies involved in regulation prior to the enactment of the Staggers Act of 1980. As a member of the National Industrial Traffic League, I actively participated in the debate regarding the formulation of the Staggers Rail Act of 1980. I supported the principles of the Staggers Rail Act when we were debating it and I support the principles now.

I believe that competition in an appropriate quantity is an effective replacement for unduly burdensome regulation. However, the reduction in the number of Class I railroads through acquisition and merger has changed the quantity and the nature of competition envisioned by Staggers.

Railroads enjoy a statutory franchise exclusivity coupled with pricing and service freedom enjoyed by no other industry in the Nation, a statutory recognition of the private property nature of railroads, and the importance of railroad service to the wellbeing of the national economy. This combination of freedom and protection is a special situation that is sufficiently different from the business situations faced by customers of the railroad particularly in their insulation from the consequences of their actions, that it creates a special condition for railroads.

In other words, railroads are a special condition, and that naturally raises our concern as a business, so we pay more attention to railroads, not only regulators, but we pay attention as their customers. In no event does anybody wish a return to the unduly burdensome regulations that we faced prior to the enactment of Staggers.

Our business is vitally dependent on railroads to move our products from our plant site to our customers while preserving their competitive value. Thus, we need reasonable transportation service at reasonable rates in order to survive. We are a captive shipper to Union Pacific, and our experience with railroad transportation is generally favorable.

Although railroads tend to use their post-Staggers pricing freedom to build economic walls around their properties against competitors, they have also at times demonstrated strong partnership with their customers, notably Roseburg Forest Products, and form a vital link between our customers and us. We find this particularly true with Union Pacific, our serving carrier, and Norfolk Southern, although they are not entirely consistent.

We enjoy large segments of our business as a direct result of our Class I railroad partners making a special effort in pricing and service to help us establish and maintain these customers. At the same time, Class I railroads are undeniably self-focused, and they pay real attention to the needs of their customers only with great difficulty. It is just the nature of the industry.

As railroads have cut their internal costs, they have forced many of the functions they formerly provided back onto their customers, functions such as car supply, car cleaning, and now rate maintenance. Important interfaces, particularly representation by sales and marketing between railroads and their customers, are becoming less effective as railroads cut back the staff that they have.

This inconsistency and continuing inward focus of railroads are symptoms that insufficient competition exists within the railroad industry and between railroads and other modes. In the current semi-deregulated environment, the willingness of railroads to vigorously compete has become largely a matter of choice and sound management, and is no longer compelled by the presence of a large number of competitors. For a railroad to state, as all have, that they must charge higher rates to captive shippers in order to enhance revenue levels that are depressed by the lower rates they charge non-captive shippers is a very clear symptom of a weakened sense of competition.

For a railroad customer to avoid expressing criticism of its serving railroad, as many of my peers have, because they fear retaliation from that railroad, is a sad statement with respect to the relationship the railroad has with its customers. The shipping public and railroads are at a critically important point. I do not advocate new regulations that would impose more competition upon railroads. I believe that existing regulations such as those providing for enhancement of competition through reciprocal switching, and the ongoing negotiations regarding the elimination of paper barriers with shortline connections, are sufficient.

I believe that both private and public negotiation between railroads and their customers, conducted in the spirit of mutual benefit and mutual self-interest, can overcome the primary disagreements that exist today. Railroads must, however, demonstrate their willingness to compete in order to retain both the exclusivity of franchise and pricing freedom they now enjoy. They must clearly state what they will do for their customers, and be prepared to be held accountable.

Likewise, railroad customers must vigorously bring the railroads into their businesses. They must clearly inform railroads what they need, obtain the railroads' commitment to meeting those needs, and then be prepared to hold the railroads accountable. If these things do not happen, railroad customers, including Roseburg, will demand and impose new regulations designed to protect the interests of the shipping public.

Thank you.

[The prepared statement of Mr. Williams follows:]

PREPARED STATEMENT OF DENNIS WILLIAMS, MANAGER OF TRANSPORTATION SERVICES, ROSEBURG FOREST PRODUCTS

To the Members of the Senate Subcommittee on Surface Transportation and Merchant Marine of the Committee on Commerce, Science, and Transportation:

I thank Senators Breaux and Smith for inviting me to speak before your Subcommittee today on my experiences in shipping via railroad. I have also prepared a more detailed summary and paper that I wish to have entered into the record of this hearing.

My name is Dennis Williams, and I am the Manager of Transportation Services for Roseburg Forest Products Company, a major manufacturer and shipper of forest products, whose headquarters are located in Dillard, Oregon, with facilities located in southwestern Oregon and northern California. We have shipped each year approximately 5,000 carloads of inbound logs and veneer and more than 12,000 carloads of finished product outbound to our customers located throughout the United States and eastern Canada. All RFP facilities are located on the Central Oregon and Pacific Railroad, a 450 mile-long switching railroad that is contractually limited to interchanging traffic to the Union Pacific Railroad. Roseburg Forest is a captive shipper.

My career in industrial traffic management began more than 34 years ago; thus I am *really* familiar with the intricacies of the pre-Staggers regulatory environment. As a member of the National Industrial Traffic League, I actively participated in the debate surrounding formulation of the Staggers Rail Act of 1980. I supported the principles of Staggers then, and I support them now. Competition, in an appropriate quantity, was and is an effective replacement for unduly burdensome regulations. However, the reduction of the number of Class 1 railroads through acquisition and merger has changed the quantity and the nature of competition envisioned by Staggers.

Railroads enjoy a statutory franchise exclusivity coupled with pricing and service freedom enjoyed by no other industry in the nation, a statutory recognition of the private property nature of railroads and the importance of the transportation service they provide to the economic well-being of our nation. This combination of freedom and protection is a special situation that is sufficiently different from the business situations faced by customers of the railroads, particularly in the immediacy of consequences to prices and actions, that railroad customers have been, and will continue to be, concerned with the railroad industry. In no event does anyone desire the return to a burdensome regulatory scheme.

Our business is vitally dependent upon railroads to move our products from our plantsites to our customers while preserving their competitive value. Thus, we need reasonable transportation service at reasonable rates in order to survive. We are a captive shipper to Union Pacific, and our experience with railroad transportation is generally favorable. Although railroads tend to use their post- Staggers pricing freedom to build economic walls around their properties against their competitors, they have also, at times, demonstrated strong partnership with their customers, forming a vital link between our customers and us. We find this particularly true with UP and NS, although they are not entirely consistent. We enjoy large segments of our business as the direct result of our Class 1 railroad partners making a special effort in pricing or service to help us establish and maintain them. At the same time, Class 1 railroads are undeniably self-focused and pay *real* attention to the needs of their customers only with great difficulty. As railroads have cut their internal costs, they have forced many of the functions they formerly provided back onto customers, functions such as car supply, car cleaning, and rate maintenance. Important interfaces, particularly representation, between railroads and their customers are becoming less effective.

This inconsistency and continuing inward-focus are symptoms that insufficient competition exists within the railroad industry and between railroads and other modes. In the current semi-deregulated environment, the willingness of railroads to vigorously compete is largely a matter of choice and sound management and is no longer forced by the presence of a large number of competitors. For a railroad to state, *as all have*, that they must charge higher rates to captive shippers in order to enhance revenue levels that are depressed by the lower rates they must give to customers who are *not* captive is a very clear symptom of a weakened sense of competition. For a railroad customer to avoid expressing criticism of its serving railroad because it fears retaliation from that railroad is a sad statement of the relationship the railroad has with its customers.

The shipping public and railroads are at a critically important point. I do not advocate new regulations that would impose more competition upon railroads. I believe that existing regulations, such as those providing for enhancement of competition through reciprocal switching and the ongoing negotiations regarding the elimination of paper barriers with short line connections, are sufficient. I believe that both private and public negotiation between railroads and their customers, conducted in the spirit of mutual benefit and mutual self-interest can overcome the primary disagreements that exist today. Railroads must, however, demonstrate their willingness to compete in order to retain both the exclusivity of franchise and pricing freedom they now enjoy. They must clearly state what they will do for their customers and prepare to be held accountable. Likewise, railroad customers must vigorously bring the railroads into their businesses. They must clearly inform railroads what they need, obtain the railroads' commitment to meet those needs, and then hold the railroads accountable. If these things do not happen, railroad customers, including Roseburg, will demand *and impose* new regulations that will protect the interests of the shipping public.

Thank you for your attention.

Railroad Competition and Competitiveness

Executive Summary

1. Roseburg Forest Products Company (RFP) Page 1

- Major manufacturer of forest products; facilities in Oregon and California.
- 70-percent of production moves by rail; 5000 cars logs and veneer inbound and 12,000 finished product outbound. 50-percent of carloads go to eastern U.S.
- Highly competitive markets, geographic and product competition.
- Freight expense 10 to 50-percent of delivered price.

2. Roseburg Rail Service Requirements Page 2

- Cost-effective transportation at competitive prices from plantsites to customers, timely delivery of product in useable condition.
- Reliable supply of railcars suitable to transport products.
- Transit time influences customer inventory expense.

3. Pre- and Post-Staggers Railroad Environment Page 2

- Before 1980 Staggers Act, arcane and constrictive regulations stifled the railroad system and national economic growth. Slow orders from nationwide deferred maintenance, northeast railroad bankruptcies stranded rail customers. (p.3)
- Competition among railroads utilized to replace most regulations. (p.3)
- Railroads partially deregulated. They remain heavily regulated. (p.4)
- Railroads initiated confidential freight rates and service agreements. (p.4)
- Number of major railroads shrank from 30 to 7 between 1980–2000. (p.4)

4. Roseburg Experience Page 5

- These comments seek to make the system better meet our needs, so they address more negatives than positives. RFP experience generally positive. (p.5)
- Regulatory change fostering competition more helpful than harmful. (p.5)
- Railroads compete for business, but build economic walls around their properties to defeat competition, e.g. high rates against competitor origins, rates for hauls over two railroads higher than for single-line hauls. (p.5)
- Shippers "captive" to one railroad cannot obtain rates as low as shippers with access to multiple railroads. Railroads proprietary about customers. (p.5)

- Regulatory freedoms of Staggers generated vigorous competition, improved railroad response time, and encouraged service/rate programs that rewarded innovators and penalized those who would not compete. SP market share of northwest business dropped from 43 to 28-percent. (p.6)
- Roseburg gained more direct access to customers from mergers among large railroads. Consolidation reduced the pool of competitors envisioned in Staggers. Railroad willingness to engage competition is a matter of choice, with most decisions made to avoid competing head-to-head. (p.6)
- Competition has led to cost cutting by railroads. Many essential railroad functions either displaced to customers or no longer offered. (p.7)
- RFP sees deficiency of compelling competitive forces on railroads. Regulations protect rail franchise exclusivity; gives pricing freedom but shields them from competitive forces faced by their customers. Railroads act for self-benefit at customer expense but fear no business loss. (p.7)
- Railcar supply is inadequate and outdated—cars often contain trash and 10-percent are mechanically unsound, causing transit delays. Railroads claim insufficient capital to replace aging cars and have told Roseburg and other shippers to acquire and operate their own boxcars. (p.8)
- Railroads, notably UP, also engage in beneficial customer partnerships, and provide competitive service and prices for mutual benefit. (p.9)
- Specific departments at UP Railroad are sharply focused on supporting RFP business for mutual benefit, how business should work. (p.9)

5. Competitive Access Page 10

- Railroad mergers reduced competitive forces to the point that a prudent amount of competition needs to be infused into the industry. Deregulation, reregulation, and open access are terms used to incite blind response to credible ideas. (p.10)
- Reciprocal switching. An existing statute whose purpose is to allow the Surface Transportation Board to enhance competition. The STB would require two or more railroads located within the same switching district to open industries located on their lines to linehaul service by other railroads, including short lines, located within that district. (p.11)
- Bottleneck rates. A proposed new regulation in which STB may require a railroad serving a captive shipper to establish reasonable rates for that shipper to the nearest interchange with a competitor railroad. (p.11)
- Paper Barriers. The STB could eliminate Class 1 railroad restrictions that prohibit a captive Short Line railroad from interchanging with competitors of the controlling Class 1 railroad. (p.11)

6. Captive Shippers Page 12

- RFP is effectively captive to Union Pacific, but, because UP and Roseburg work hard to cooperate, the relationship has been generally fruitful. (p.12)
- Captivity results in freight costs higher than RFP would have with direct access to BNSF, but RFP has not yet pursued access to BNSF. (p.12)
- Reprisal fear, long felt by many shippers, is now a consideration at RFP. (p.12)

7. Railroad Capital Needs Page 13

- Railroads must add physical capacity to satisfy demand for transportation, and they are spending billions to meet present and future demand. (p.13)
- Short Line railroads in particular need cash to upgrade lines to handle heavier loads (286,000 pounds per car) now common on Class 1's. (p.13)

Hon. GORDON SMITH,
Washington, DC.

Dear Senator Smith:

Roseburg Forest Products Company (RFP) is a major manufacturer and distributor of forest products with facilities located in Oregon and northern California. Our products are lumber, plywood, particleboard, laminated veneer lumber, wood I—joists, and value-added products we make from these materials. We are located exclusively on the Central Oregon and Pacific Railroad, a 450-mile short line switching railroad whose Class I connection is contractually restricted to Union Pacific for rates, linehaul service, and railcar supply. We ship about 12,000 carloads of outbound finished products each year throughout the U.S. and Canada, and receive another 5,000 carloads of inbound materials such as logs and veneer. We ship almost

70-percent of our annual production by rail, and nearly 50-percent of our carload shipments move to destinations east of the Mississippi River. RFP is a good partner to railroads and regulatory agencies, because we negotiate from a win-win basis, and we communicate accurately, plainly, and abundantly.

We are vitally dependent upon railroad service, because our products are relatively low-value, compared to most inter-city freight. Since the volume of our production substantially exceeds demand for our products in the Northwest, we must move long distances to our customers. The importance of competitive freight rates is shown by the fact that freight expense is between 10-percent and 50-percent of our delivered prices, a substantial percentage compared with other products moving in intercity freight. Our markets are highly competitive and cost-sensitive. Our products compete with those made by manufacturers in the Northwest as well as those made by producers located closer to our customers than we are, whose freight expense is only a fraction of ours. Our products also compete with substitute goods made of concrete, steel, plastic, and other material. Railroads represent the only economical mode for moving the full volume of our products to distant markets. Trucking costs are too high to allow our products to be competitive over long distances, and waterborne modes are either too slow or do not serve sufficient destinations to support our business.

Our perspective of railroads is focused on four primary aspects: (1. Freight rates, (2. Equipment, (3. Service adequacy, and (4. Strategic Transportation supply. With respect to rates, we, as does everyone, don't want to pay more than we have to, but we don't blindly engage in rate cutting. We require our rates to be genuinely competitive and to reflect the economies of scale our operations and shipping patterns generate for the railroad. We seek value and fairness. Our perspective on equipment is that while railroads have the exclusive right to supply equipment for loading, with that right comes the obligation to supply cars that are structurally and mechanically sound, reasonably clean, and fit the railroad's capabilities for freight cost optimization. When we speak of service adequacy, we refer to both linehaul and origin/destination switching. Railroad transit times must be competitive with other modes and origins, and they must be reasonably consistent. We disagree with the position that transit consistency is more important than transit time, because transit directly influences inventory levels that our customers maintain. Time and consistency are equally important. Strategically, we pay much attention to long-term railroad issues. We are convinced of the need for railroads to expand their plant capacity, because, as the nation's economy grows, demand for rail transportation will increase. Rail capacity must be adequate to meet demand, or it will stifle economic growth. We encourage railroads by our actions and words to foster capacity growth by developing adequate present and future transportation resources.

The point of our transportation exercise is to move our products from our plants to wherever our customers want them while preserving their competitive value. To accomplish this, we require rail service that provides a reliable supply of cars for loading, moves our products at competitive prices with reasonably expedient transit times, and delivers our products in a condition useable by our customers. These factors are inextricably linked in determining our success in meeting customers' needs. Car supply reliability is important because customers expect their orders to ship within a specific agreed-upon period of time, so cars must be available when orders are ready to ship. Transit times affect the value of our products nearly as much as freight rates, because they directly affect the size of inventories, and capital investment in inventories, our customers maintain to support their business. Finally, customers purchase our products for a specific use, and, from their perspective, if our products arrive wet, damaged, or otherwise unsuitable for their purposes, we have failed to deliver them and might as well have not shipped them at all.

PRE-STAGGERS REGULATIONS

The regulatory climate within which we purchase transportation service by railroad has evolved from an arcane and stifling system of regulation that existed for decades prior to enactment of the Staggers Rail Act of 1980. Railroads were treated as utilities and were governed by a constrictive set of regulations written to control monopolies. A good illustration of this oppressive system can be found in its treatment of rates. Before Staggers, all freight rates were calculated in accord with exact formulas prescribed by the ICC. Factors within these formulas were defined by case law and were interpreted and applied by railroad rate bureaus, regional groups of railroads that were granted antitrust immunity to collectively make rates. A rate could not favor one shipper over another, regardless of comparable economies of scale or operating efficiencies, and it had to apply over nearly every possible combination of railroads that existed between a shipment's origin and destination. A rate could not be changed without concurrence of every railroad that might possibly participate in using it. Rate reductions proposed by an individual railroad to gain new business were usually thwarted by that railroad's competitors who refused to give their concurrence, thus making new traffic difficult to obtain, even as railroads were losing their existing carload traffic to the trucking industry. The purpose of this constrictive regulatory system was to prevent railroads from abusing their power over the shipping public. The system made changes in railroad pricing and operation so onerous that they took forever to implement, so most railroads avoided change. That system was financially strangling the railroad industry. Immediately prior to enactment of the Staggers Act, nearly a third of the nation's railroad trackage was under slow orders, due to deferred maintenance, and the country's northeast was nearly paralyzed by a swarm of railroad bankruptcies.

My transportation career began during this time, and I still shudder to recall the tedious minutiae that ruled this vital segment of the national economy. Few industry traffic managers and railroad employees today actually experienced this period. Most don't believe that we could return to the bureaucracies within railroads, government, and industry that pre-Staggers regulations required. I believe differently. The present health care billing system exemplifies how over-regulation used to stifle the railroad industry. The green eye shade and sleeve garter mentality flourishes within the bureaucracies created by HMOs, regulators, and industry staff that are required to contend with the "new" system. Any of these can glaze one's eyes every bit as quickly as used to occur from a freight clerk's explanation of the approximation of Class 100. The shipping public can not afford a return to that type of system in transportation.

THE STAGGERS ACT OF 1980—PARTIAL DEREGULATION

Congress formulated The Staggers Act through cooperation and extensive negotiation between railroads and the shipping public. The new law's purpose was to obviate most previous regulatory constraints by fostering independent action and competition among railroads. Staggers envisioned that if railroads acted independently and competed with each other, they would conduct themselves more as normal businesses; focusing upon serving customers, the true source of their revenues, and thereby earn greater profits and attract much-needed capital. Concurrently, railroads would be unable to abuse their market power over their customers, because such acts would cause them to lose business to their intra- and intermodal competitors. The framers of the Staggers Act expected that a sufficient number of railroads would exist to provide effective competition for each other. It is important to note that Staggers did not deregulate the railroad industry—railroads were still heavily regulated and remain so to this day. Rather, Staggers allowed railroads more freedom to individually price and change their service product as other industries do.

The Staggers Act allowed railroads to set their freight rates upon any basis they chose—cost or market or, sometimes, whim—with very broad latitude of action. On the low side, a rate must at least contribute to the going concern value of a railroad. On the high side, limits are set by commodity, with the ceiling set at replacement cost value. This interesting limit states that rates can be so high as to equal the cost a railroad customer would experience were they to build and operate their own railroad line between the points at issue—a very high ceiling, indeed. Staggers encouraged regulators to exempt specific commodities and identifiable classes of traffic from all pricing control. Forest products rates are exempt from price regulation; thus, railroads have complete freedom to set rates on our shipments.

Staggers allowed railroads to enter into confidential contracts with customers. Prior law required all rates to be open to the public, and shippers knew their competitors' rates. Under confidential contract rates, we don't know all our competitors' rates, and they don't know ours. An interesting side note; despite "common wisdom" among shippers and railroads that rate confidentiality is a myth, my experience is that a shipper, through concerted effort, can keep its contracts confidential. Confidentiality is, of course, a two-edged sword. We benefit where it protects our business and are harmed by competitors who take away our business using confidential rates. Confidentiality also makes the task more difficult of identifying situations where we are hurt by unjustly discriminatory rate practices by railroads. Nonetheless, we accept confidentiality's importance to free enterprise in the real world. It forces all parties to do business better, rewarding efficiency and penalizing mediocrity.

Staggers also eased the process for merger, acquisition, and abandonment among railroads. Until the Surface Transportation Board took "time out" before the proposed BNSF/CN merger, the ICC and its successor agency, the STB, allowed railroads to merge and acquire other railroads in every transaction that was not both blatantly anti-competitive *and* accompanied by overt disregard for the regulatory process. Merger and acquisition have reduced the number of major railroads from more than 30, when Staggers was enacted, to the present level of 7, a reduction whose significance I will explain further.

ROSEBURG FOREST PRODUCTS COMPANY EXPERIENCE

Some things work well within the present system and some don't. This letter's purpose is to help the system better meet our needs, and my comments will address more things that need improvement than those that work well. My experience is generally positive, especially with the UP railroad.

At Roseburg, we have seen tremendous change, attributable to enactment of Staggers, in our ability to market our products using railroad service. Our present situation reflects change that has been much more beneficial than adverse. The most predominant initial effect of Staggers was that railroads began "competing" by building economic walls around their properties, insulating their on-line business from competitor railroads, a practice that continues today. The three primary railroads in the northwest, BN, UP, and SP used their Staggers freedom to either outright cancel their joint rates with each other (rates covering business shared with each other) or create rate differentials favoring single line (unshared) business. For example, a 500-mile haul from a UP-served mill to a UP-served customer might carry a $500 single-line rate, and a 500-mile haul from a BN-served mill to a BN-served customer might have a $500 rate. However, a 500-mile haul from a UP-served mill to a BN-served customer is always more expensive than either single-line rate. Thus, shippers located on a given railroad realize an advantage to destinations located on their railroad and its "friendly connections" but are disadvantaged to destinations on a competitor railroad.

Shippers who are restricted to linehaul by only one railroad are termed "captive" to that railroad. Roseburg Forest was "captive" to SP, and we remained "captive" when UP acquired SP. Our competitive circumstances contrast markedly with those of "non-captive" shippers. Generally, shippers whose facilities are open to linehaul service by two or more railroads have a substantial advantage over shippers located on a single railroad, because they have access to both railroads' single-line rates. These favorably situated shippers gain further advantage by leveraging one railroad against another, to common destinations, to obtain additional single-line rate reductions.

Staggers provisions that allowed railroads to act independently from each other generated vigorous competition. Railroads began utilizing their own single-line tariffs and letter quotes (confidential contracts) to the extent that collective action in rate bureau tariffs virtually disappeared for rate publishing purposes. A significant change we noted was the improved speed with which railroads incorporated rate changes. Where Southern Pacific, our serving railroad, formerly took 6 months to respond negatively to our requests for reduced rates, Staggers provisions allowed it to shorten its reaction time to a couple weeks, and ultimately to a few days. Its response was still negative, but much faster. Following purchase of SP by UP, we enjoy quick response today from UP, and we note that its response is more often positive than negative.

Railroads began developing and implementing innovative rate programs. When SP denied its origin traffic to BN and UP by canceling its joint-line rates with them, the two railroads, separately, initiated aggressive origin reload programs for the purpose of regaining SP-origin traffic volumes they previously enjoyed. In these programs, UP or BN contracted the services of a truck/rail transloader who was located on its line near a group of SP-served mills. The railroad then established very low contract linehaul rates from that "reload" facility to eastern, SP-competitive destinations so that the combination of trucking, reloading, and UP or BN linehaul charges from the SP-served mill through the reload was lower than the SP rate from the SP origin. UP and BN, bluntly, ate SP's lunch. These programs, in several successive configurations, were so successful that UP and BN, acting in similar fashion but independently of each other, reduced the SP market share of forest products carload traffic from 43-percent to 28-percent during the 1980's. SP served more than 60-percent of forest products manufacturing facilities in the Northwest, and the UP and BN accomplishment is noteworthy as an example of competition at a very effective level. Ultimately, SP reduced its rates to meet UP and BN competition. SP's action resulted in Northwest forest products' freight rates becoming more competitive in distant eastern markets, markets that were relatively unimportant to SP at the time, but which became extremely important to our business.

Staggers provisions that eased merger and acquisition among railroads have dramatically affected our business. Class 1 railroads effectively control the nation's rail system. As the result of acquisition and merger during the past 20 years, the Class 1 railroad system is now composed of two primary western railroads (UP and BNSF), two primary eastern railroads (NS and CSXT), two Canadian railroads

(CPRS and CN), and KCS. We at Roseburg have been fortunate during this consolidation process, in that we are effectively on UP, the nation's largest railroad, and have single-line access to the largest customer base of any railroad. During consolidation of several railroads into the present UP system, we gained single-line access to customers located on DRGW, UP, CNW, MP, WP, and MKT. We lost only ATSF as a friendly connection, as it merged with BN, a competitor of UP. All other Class 1 railroads are friendly connections, equally accessible to UP and BNSF. Thus, we gained more than we lost in the way of reasonable access to customers during these past mergers. However, we stand to lose access to customers as a result of future mergers.

Consolidation of the nation's railroad system has removed almost 30 railroads from the competitive pool that Staggers envisioned as a replacement to regulation. Competition is not so prevalent among railroads as it was when there were a large number of competitors, and the very nature of the competition that remains is different from the forces anticipated by Staggers. The degree to which railroads will recognize and engage competition is now largely a matter of choice, and their aggressiveness is dependent upon the individual railroad's will and ability to compete. Railroads face less competition, but their competitors are stronger and more formidable, and individual railroads are very wary of taking action against a competitor. We are often frustrated by a negative response from a railroad that chooses to not start a "rate war" with its competitor. Railroads, generally, are now more proprietary about their customers, particularly those who are captive. As railroads make more choices to *not* compete with each other, they have become more self-focused. Railroad action and attitude can be fairly characterized as cost-cutting for their own benefit, with many of the customer service functions they formerly performed now either pushed onto their customers or no longer offered. Importantly, we recognize that railroad cost reduction efforts have been mandated by their customers who, facing greater competitive pressure in their own businesses, have demanded rate reductions as part of their own activity to cut costs. At the same time, railroads are public companies with profit targets to achieve and stockholders to satisfy. I will illustrate some of the ways in which railroads have responded to these conflicting pressures.

Generally, we sense that the nation's railroads feel a sufficient lack of competitive pressure from each other so that they believe they have substantial latitude to take actions that solely benefit themselves, at the expense of their customers, without fear of losing business to competitor railroads and trucks. Railroads price their services with the same degree of freedom that most businesses enjoy, but their specific situation contrasts sharply from most other industries that exercise pricing freedom. The remaining economic regulations that protect the exclusivity of railroad franchises serve to insulate railroads from the full force of economic consequences of their anti-competitive actions, unlike the forces with which other industries must contend. If one of our customers doesn't like our products, for any reason, they can readily buy like products from one of our competitors. However, if we don't like the service being provided by the railroad, we cannot economically buy commensurate service from its competitor. Railroad actions that created post-merger service crises, the severity of these service failures, and the prolonged recovery time from these crises are all symptomatic of railroads feeling little fear of competitive business loss.

Railroads have begun limiting their handling of freight damage claims and overcharge claims. Deciding that small claims are not cost-effective to process, railroads have advised shippers that they will no longer accept cargo damage claims of less than $250, even if they caused the damage. UP has recently announced it will not accept claims to recover freight bill overcharges, regardless of their cause, for amounts less than $100. Our experience has been that 95-percent of freight bill errors favor the railroad, and that the complex, confidential contract pricing system that predominates modern railroads is conducive to freight bill errors. Furthermore, railroads have begun imposing finance charges against their customers for payment of freight bills beyond their credit period, so the time we have to protect our interests by performing pre-payment freight bill audit is becoming very limited.

Railroads charge exorbitant rates to switch cars coming from competitor railroads, within a given city, to their customers who are closed to reciprocal switching. This is to discourage shippers located on competing railroads from doing business with customers located on their lines. Unlike the rate structure for most industries, Forest Products freight rates, when more than one railroad is involved in a haul, uses combinations of single line rates, rather than single-factor, joint rates available to most other industries. Railroads do establish joint rates, but they are almost invariably higher than the sum of each railroad's single line rates. Thus, a shipper on UP who ships to a customer located on BNSF must pay the UP linehaul rate to the UP/BNSF interchange and also pay a separate BNSF linehaul rate from interchange to the destination. Even if the customer's location is a city served by both UP and BNSF, if that customer is closed to reciprocal switching, the shipper must pay a BNSF minimum linehaul rate, about $800, in addition to the UP linehaul rate to that destination. Since most railroad single line rates are similar to each other between like points, a forest products shipper located on BNSF has a freight cost advantage of about $800 over its UP-located competitor. If the customer were open to reciprocal switching, a much lower BNSF switch charge would apply, and that switch charge would be absorbed by UP. Even so, BNSF apparently feels that the $800 penalty is insufficient to insulate its captive customers, so it raised its minimum linehaul charge to $1,124, a clearly anti-competitive move.

The law requires railroads to provide reasonable car service, which means, in part, the railroad is obligated to provide equipment suitable for loading. With that obligation comes the right to be the exclusive supplier of equipment types the railroad chooses to provide, namely all major car types except tank cars. Despite the railroad's duty to provide equipment suitable for loading, we receive many, many boxcars for loading that contain debris and trash from prior loads of some other business. We have to either reject these dirty cars (losing use of that car spot for the entire day) or use our loading crews to clean and dispose of the debris, an expensive proposition. When railroads operated with 5-man crews, they inspected "empty" boxcars before they were removed from a customer's siding. If a car were found to contain debris from its prior load, the railroad crew refused to move it until the receiver cleaned it, and the receiver was subject to demurrage penalties for delaying the car's release. For some businesses, railroads even maintained a system of cleaning stations for empty cars prior to their being spotted for loading. Now, railroads don't take time to inspect cars, and they are closing the car cleaning stations. If shippers want cars suitable for loading, they have to bear the expense of cleaning them.

We receive many, many empty boxcars that have holes in their roof, holes in their walls, bowed doors, or other mechanical defects that allow our products to be damaged by the elements. We have to thoroughly inspect every car we receive. Candidly, a large portion of the boxcar fleet the railroad provides for us to load should be reclassified as archaeological artifacts. We reject empty cars whose condition is obviously inadequate to carry our products, thus losing utility of that car space for the day. We repair holes in cars that are repairable and notify the railroad of the need for permanent repair to that car. Despite our care, nearly one in every ten of our shipments is delayed in transit because the railcar has to be mechanically repaired while enroute to our customer. It is important to note that poor car quality and inadequate car supply cost Roseburg revenue that we would have reinvested in our own plants, generating even greater revenue for both ourselves and for the railroad. The railroad has repeatedly advised us that it will replace this equipment, but it has not. The railroad states that it does not have sufficient capital to replace these cars with suitable equipment and has repeatedly advised customers to acquire their own boxcars.

Fortunately, our experience is that we enjoy a very strong partnership with our serving railroad, CORP, and its Class 1 connection, UP. In particular, the operating and commercial divisions of Union Pacific have demonstrated genuine desire to provide Roseburg with competitive service and prices. Service improvement implemented by UP since its acquisition of SP has been particularly gratifying. It has been a successful effort that is driven not only by the railroad's obvious desire for improved profit, but as part of a clear, customer-oriented motivation that is shared throughout the leadership and rank-and-file of the railroad's operating department. In some respects, UP creates the appearance of being unconcerned about its competitors' manifest traffic service levels, because its people are so focused on optimizing service over its own lines for the mutual benefit of itself and for its customers.

In order to protect their existing business, some railroads, such as UP and NS, are noticeably more knowledgeable of their customers' markets and have become a valuable information resource to the shippers they serve. We often depend upon non-proprietary information from railroads to improve effectiveness of our marketing programs and gain insight into our customers' business from a different industry's perspective. Such information sharing helps all parties and promotes awareness of the partnership nature of our relationship with the railroad, a relationship that was beyond comprehension prior to Staggers. Railroads sometime reward distinctive business of individual shippers by differentiating rates among manufacturers of like products to protect that business.

The UP and NS marketing and pricing divisions are sharply focused on the products that form the vast majority of our shipments, plywood and particleboard products, and they have made extraordinary effort to help us remain competitive to customers located on their lines. UP and NS have acted as genuine partners in pricing their service to cooperatively maintain and increase our mutual business. The commercial side of the UP railroad has supplied special equipment for our use to help reduce the negative effect of its normal, aged fleet. UP and NS have also repeatedly taken selective pricing action, as a supplement to our own actions, in very specifically defined, competitive business situations where we saw mutual opportunity to preserve and generate business and where contribution by the railroad was appropriate. UP will often use Roseburg to develop and validate innovative programs. We have often been advised by UP representatives as we discuss something new that, "If it works for Roseburg, we can make it work for other businesses". Benefit builds upon benefit. This is the way business with railroads is supposed to work.

COMPETITIVE ACCESS

A major debate among railroads and their customers is the effectiveness of present levels of competition in replacing burdensome economic regulation of railroads. Hard-line proponents from each side in this debate have confused both issues and remedies to the extent that progress in identifying problems and their solutions is diffused and lags the economy's pressing need for resolution.

From our perspective, the pressing issues in this debate are: (1. whether or not sufficient competition exists to achieve the goals set forth when railroads were partially deregulated, and (2. the need to provide proper definition to the terms "deregulation", "re-regulation", "open access", and "competitive access".

I believe that the competition-driven actions by railroads today are the result of *choices* by railroad management exercising sound (or unsound, in some instances) long-term business judgement. Insufficient raw competition exists among railroads to, by itself, compel railroads to provide service and prices that are needed by the businesses they serve. The numeric decline in major railroad participants of the industry, through mergers and acquisitions since the Staggers Act became effective, is sufficiently great that something needs to be done to infuse a prudent quantity of competitive forces into the system.

"Deregulation"—Representatives of railroads have repeatedly used the term "deregulation" to describe the present status of the railroad industry. This is an inaccurate description, because it implies that all former regulations pertaining to railroads have been eliminated. They have not. Staggers and subsequent regulations eliminated the unduly burdensome aspects of the law, but did not eliminate all economic regulation. The ICC and STB have *exempted* many specific segments of the railroad business from economic regulation, such as forest products and all traffic moving in boxcars. However, those exemptions are conditioned upon railroads acting in accord with existing regulations that spell out general standards of behavior, primarily that railroads will not abuse their market power over the shipping public. Exemptions that railroads and the shipping public presently enjoy are, by their own words, subject to reversal.

"Re-regulation"—The word "re-regulation" has also been used by railroad industry representatives to describe a return to the full book of economic regulations that existed prior to Staggers. The word has been applied to virtually any action that calls for any change in current regulatory language, usage that is as inaccurate and inappropriate in this debate as the word "deregulation".

"Open access" is a phrase actually used by a small cadre of shippers to propose a controversial system in which railroads would be required to allow other railroads, and even non-railroads, to operate over their properties in competitive business. Aside from its obvious conflict with constitutional provisions regarding the taking of property without due process, the plan is unworkable in a private enterprise environment. The phrase is now used by railroads to paint any proposal to enhance competition among railroads.

"Competitive access" has been used by shipper proponents of increased competition to describe a variety of pro-competitive remedies, including open access. There are three principal proposals that are embodied in this debate that could be described as "competitive access." They are:

- Reciprocal switching—Many railroad customers are located in cities served by two or more Class 1 railroads, and are designated by their serving railroad as "open to reciprocal switching". This means that these customers, although served directly by only one of these railroads, have equal access to linehaul service, *and single line rates*, from both railroads. In such instances, the railroad that directly serves the customer will assess a switching charge to move the railcar either to or from the competitor railroad. This switching charge is absorbed by the linehaul railroad and is not added to the linehaul railroad's single line rate. These railroads must compete head-to-head with each other for those customers' business. In the post-Staggers era, however, we and an increasing number of our customers are "closed to reciprocal switching", that is, their serving railroad demands a linehaul move whose cost is added to a competitor railroad's single line rates to that destination, a severe economic disincentive to competition. An existing statute allows the Surface Transportation Board, *at its option*, to prescribe reciprocal switching, that is, to order competing railroads to open an industry or group of industries to reciprocal switching as a means to "enhance competition" within the railroad industry. A reciprocal switching agreement prescribed by the Surface Transportation Board would require railroads to open every industry they serve within a given switching district to linehaul transportation by competing railroads. Each railroad would absorb the other's switching charges. Within the context of this debate, the Surface Transportation Board would prescribe mandatory reciprocal switching at all stations served by two or more railroads, including industries on short line switching roads who serve that station.

- Bottleneck rates—For shippers located at a station served by only a single Class 1 railroad, the Surface Transportation Board could require the serving railroad to establish a reasonable rate to the nearest interchange with a competing railroad. That competing railroad could then handle the shipper's traffic in linehaul service. Presently, the serving railroad can refuse to establish any rate whatsoever to its competitor's nearest interchange. The STB would retain jurisdiction over the serving railroad's bottleneck rate, and if the bottleneck rate were unreasonably high, the STB could prescribe a rate.
- Paper barriers—A railroad may, as part of the sale or lease of trackage to a short line railroad, restrict or prohibit the short line's interchange of traffic to any other railroad. These restrictions are common in dealings between Class 1 railroads and short lines that seek to acquire lines formerly controlled by the Class 1. The proposal at issue would eliminate such restrictions, allowing the short line to interchange traffic with any railroad connection, including a competitor of the granting railroad.

CAPTIVE SHIPPERS

Railroad customers who are served by only one railroad and have little or no economic access to competing railroads are termed "captive". Although simple economic principles of price and supply regarding transportation service suggest that captivity is a severe disadvantage, this has not been our experience. We at Roseburg enjoy a strong partnership with Union Pacific and our short-line connection, Central Oregon and Pacific, that our captive status has forced us to develop and maintain with the railroads. Concurrently, Roseburg represents a substantial share of UP's business in the Pacific Northwest. For its part, UP recognizes and demonstrates, in most of its actions, that by supporting our business and responding effectively to our needs, we will be competitive in our markets, and it will gain business.

Despite the close relationship we enjoy with UP, we have experienced instances where UP, recognizing our captive status, has not responded as quickly and aggressively to our needs as our business required. Particularly noteworthy in this debate are the acknowledgements by railroads, including UP, that they do indeed charge higher rates to captive customers than they do to those who are not captive. Railroads repeatedly state that they must charge higher rates to captive customers to enhance railroad revenue levels that are depressed by the lower rates they must give to customers who are *not* captive; that is, those who have access to more than one railroad and *have* competitive options. We strongly object to the concept that captive customers must subsidize non-captive customers, particularly when those non-captive shippers are competitors of ours. Here, more than anywhere else, is a clear statement by railroads that they respond to competitive pressures, and will readily discriminate against customers who have limited competitive alternatives. The intent of partial deregulation of the railroad industry was to remove regulatory obstacles that prevented railroads from doing the things necessary to serve their customers better. The intent of Staggers was emphatically not to create a group of financially healthy railroads whose business existed in a vacuum, but to create entities who could provide better transportation service to the industries that comprise the nation's economy. We would be outraged to find that a former customer is being served by a competitor whose advantage over us stems *solely* from the fact that it has access to competing railroads, while we do not.

Balancing the two sides of this issue, our present favorable status is dependent upon maintaining a cooperative relationship with UP and upon the good will of UP management toward our company. We have, in the past, experienced the effect of unfavorable management on railroad predecessors of UP, to the detriment of our business, and we realize the possibility exists that at some point in the future, we may again experience problems. Prudence suggests that we should pursue access to both UP and BNSF. The fact is, however, that we have experience with limited competitive access to BNSF, and that BNSF proved to be only a lukewarm competitor to UP. In view of the many benefits we derive from our good relationship with UP, we do not feel compelled to pursue competitive access to BNSF at the expense of our good will with UP. However, to correct competitive deficiency we see on other railroads, we would support a nationwide prescription by the STB of mandatory reciprocal switching agreements among all railroads as a reasonable yet minimally intrusive step toward enhancing competition.

A final aspect of shipper captivity concerns the fear expressed by a great many railroad customers that if they openly criticize a railroad and its practices, they will be targeted by that railroad for retaliation. This fear is a sad commentary on the nature of the relationship between railroads and their customers, but it is a genuine, and sometimes paralyzing, concern for many companies. In my 34-year career in industrial traffic management, I had never, until this year, experienced retaliatory action by a railroad. I have always been candid in my communication with railroads, and I have always found the predominant reaction, even when my comments were critical of specific railroad practices, to be reasonable. Railroads have disagreed with my assessment of a given situation, but, until recently, disagreement has always led to discussion, education, and ultimate improvement. That has changed, and the absence of effective competition is at the heart of the retaliation we have experienced.

I noted in my earlier comments that nearly 50-percent of our rail shipments go to destinations east of the Mississippi River. For that distance, freight occupies a considerable percentage of our delivered cost, and our business is always at risk from competitive products. Therefore, we are particularly diligent in managing these costs. We strongly objected when one eastern railroad raised our rates by a very substantial amount to a customer of ours that was captive on its line, putting our business with that customer at risk to geographic competition. When the railroad refused to consider modifying our rates, we began looking for alternative ways of servicing this customer and others who were similarly situated. We determined that by positioning a forward inventory of our products at an intermodal facility (rail to truck transfer) in the vicinity of these customers and delivering their shipments by truck, we could realize inventory cost savings sufficient to maintain our previous delivered prices. At the same time, we could improve the reliability of our deliveries to these customers, increasing the value of our products and service. Since we had our choice of "reload" facilities, we offered this railroad the opportunity to bid on a competitive basis for this business, and it offered rates that were a substantial reduction to its normal prices, far below its initial rate levels. However, the rates it offered were not as low as rates offered by its competitors, and it lost the business. When advised of this outcome, that railroad responded by contacting our customer and literally accusing us of trying to "cheat" that customer of the proceeds from a confidential allowance the railroad had entered into with our customer (and not with us) on movement of our products. Our customer, predictably, was outraged and threatened to terminate our business relationship. We are still working to restore that customer's trust.

RAILROAD CAPITAL NEEDS

Railroads are capital intensive industries whose physical plants and rolling stock require substantial maintenance. UP estimates, reliably, that it needs to spend $1 billion each year on its plant just to maintain its condition.

Economic growth of the nation will require substantial increase in transportation capacity, and railroads must add capacity to their plants if they are to avoid constraining the country's commerce. All major railroads, especially UP, have recognized this fact and have been spending billions of dollars to add capacity. Capital available to the railroads has been particularly strained by the number of major projects either planned or under way and will continue to be tight into the foreseeable future. This acute shortage of capital has also become a serious problem for smaller railroads. Class 1 railroad trackage is generally open to carry individual railcars weighing up to 286,000 pounds gross weight on rail. However, most smaller railroads, especially Class 2 and Class 3 railroads associated with former Class 1 branch lines, cannot handle such heavy loads without accelerating deterioration of their roadbeds, and many cannot handle them at all. They are faced with the expense of upgrading most, if not all, of their trackage to the 286,000 pound gross weight standard. Unless they do this, however, the customers they serve will face a severe competitive disadvantage in moving shipments to their markets. This capital challenge is approaching crisis proportions and has led to our support for specific provisions found within legislation before Congress that would provide grants and low-cost loans to railroads for purposes of upgrading their line capacities.

Railroads have turned to their customers for help with their capital needs by encouraging shippers to acquire and utilize their own railcars. Because of the pressing need for railroads to continue giving emphasis in their capital budgets for basic plant expansion, we acted upon the railroad's request by offering to acquire, for the first time in our history, a fleet of boxcars to handle our shipments. Furthermore, in order to improve railcar utilization, we offered to put these cars under UP control for the purpose of its securing westbound re-loads from origins located on the lines of its friendly connections. This was an innovative program UP developed with Roseburg to complement our predominantly eastbound loading patterns, thereby improving railcar utilization and reducing railroad costs. The proposal we developed in conjunction with a major railcar builder/lessor contained a number of innovative, mutually favorable features designed to make it work to the benefit of all parties in the transaction, to partner with the railroads in the way a good partnership should work. However, UP allowed us to get to the point where we had only to say "go" to the car builder, then it denied us permission to proceed, invoking its statutory authority to be the sole provider of equipment. However, in subsequent discussion with UP we were able, with UP cooperation, to develop a final innovative plan that embraced the benefits we and the car builder had presented while working through UP's capital constraints. UP ultimately agreed to provide these cars under terms even more favorable than those we had been able to develop. Thus, we all won.

Thank you for your attention, and I would be happy to discuss these matters further with you and your staff at any time.

Respectfully,

DENNIS WILLIAMS,
Manager Transportation Services,
Roseburg Forest Products Company.

Senator ROCKEFELLER. Thank you, Mr. Williams, very, very much. I would like to turn now to Mr. Strege, representing the Grain Dealers of North Dakota.

STATEMENT OF STEVE STREGE, EXECUTIVE VICE PRESIDENT, NORTH DAKOTA GRAIN DEALERS ASSOCIATION

Mr. STREGE. Thank you, Senator Rockefeller.

Senator ROCKEFELLER. Could you pull that mike up?

Mr. STREGE. Thanks to all of you who had a part in setting up this hearing and for allowing us to be a part of it. Senator Dorgan, thank you for your persistent efforts on behalf of grain shippers and railroad shippers in general for all of your 21 years here in Congress.

Our association is a member of the National Grain and Feed Association, and the Alliance for Rail Competition. Our situation is similar to many in those organizations, and the reason I am here today boils down to this, that a decreasing number of ever-larger railroads have accumulated great economic and market power. This power is displayed through railroad rates, charges, penalties, and practices that could not exist in a truly competitive environment, and it is damaging many in our industry.

This is much more than a debate about who is going to get what percentage of the economic pie. For grain elevators and many processors, it is about whether they will even remain in business to serve their customers, and it is about the viability of farmers, rural communities, and urban centers in the many areas of this Nation where agriculture is important. Large railroads will continue to operate whether grain shippers use them or not, but for each and every grain elevator dependent on rail, the railroad service and pricing are a matter of life and death. That is how important railroads are to us.

The major Class I railroads have been granted their merger franchises by the Government. With those powerful franchises should come a greater level of responsibilities to the communities served than has been exhibited. What we are asking is that Congress redirect rail policy to correct this imbalance of interest.

In the past year, we have seen a clear example of this life-and-death market power through the Burlington Northern-Santa Fe inverse rates on spring wheat to the Pacific Northwest ports. Senator Dorgan has described that previously. All of a sudden, shippers in the western part of our State and in Montana woke up to find out that a few selected shippers many hundreds of miles farther east had a much lower rate than they did to the West Coast. This does not make sense, but it is a manipulation of the market by a dominant rail carrier, the BNSF.

Now, the BNSF has announced that these rates expire today, after more than a year of doing market harm, but there is nothing to prevent them from putting those back into effect tomorrow. Indeed, their CEO has kept the door open for that kind of ratemaking in the future. Other examples of market power are in my written statement and that of the National Grain and Feed Association.

This situation with the BNSF is so serious that it brought the Governors of North and South Dakota, Montana, Nebraska, and Wyoming together to write a joint letter of concern to the CEO of BNSF. The response caused our Governor, John Hoeven, to comment that, "BNSF actions will not cause us to step back from pursuing Federal regulation and other measures that address a lack of competition in the grain shipping railway industry."

Gentlemen, we believe that where competition exists, competition should govern business activities, but where competition is nonexistent, or inadequate, then something else must be there to protect the interest of customers. During the past two decades the ICC and the STB were approving rail mergers, thus concentrating great market power in the hands of a few large railroads. Given this market power, acquired through Government action, we believe that Congress must now act to make oversight more effective.

Page 11 of my written testimony lists some possible remedies for your consideration. I will also add that because we do not have certain remedies listed there that are suggested by others, we are not implying that we are opposed to them. I would just like to pick out a couple to emphasize here in the interests of time: to simplify the rate reasonableness proceedings for small volume shippers, and to put the teeth back into the anti-discrimination provision of the statute, and consider the arbitration as a way of resolving disputes with railroads.

I would urge you to start on this agenda very quickly, because the clock is ticking on many shippers and segments of our industry as railroads flex their muscles. Railroads have the power to make or break shippers, receivers, or markets, for what they see as short-term gains for themselves, and once this economic landscape has been changed because of railroad actions not necessarily related to competitive economics, there will be no turning back.

Thank you, and I will try to respond to questions later.

[The prepared statements of Mr. Strege and The National Grain and Feed Association follows:]

PREPARED STATEMENT OF STEVE STREGE, EXECUTIVE VICE PRESIDENT, NORTH DAKOTA GRAIN DEALERS ASSOCIATION

My name is Steve Strege, executive vice president of the North Dakota Grain Dealers Association, a 91 year-old voluntary membership trade association which seeks to represent the interests of the approximately 400 country grain elevators of our state. We also have members in surrounding states, and are affiliated with the National Grain and Feed Association, which is submitting its own written testimony in this proceeding. Personally, I am a farm kid who once hauled grain by small truck to local country elevators for further shipment by rail. Thus my attention to the importance of railroads goes back more than 40 years, the last 26 of those with this association.

Thank you for inviting me to testify on grain rail transportation issues. These are critical to farmers, grain elevator operators, food processors, the economies of our states and the nation, and all of us as consumers. All of us have an interest in a vibrant profitable rail system. But it seems we've gotten somewhat off the track in how to have such a network.

I will endeavor to cover these basic issues:

1. The imbalance of market power between large railroads and grain shippers.
2. Use of market power in treatment of shippers, especially captive shippers.
3. Oversight is inadequate.
4. Possible remedies for Congress and the STB to consider.

IMBALANCE OF MARKET POWER

This first point is easily explained. The nation's railroads have consolidated down to four gigantic companies controlling 90-percent or more of intercity freight. Some of them dominate geographic regions of the country.

On the other hand, grain shippers such as country grain elevators are many, and dispersed over the land to which they are tied for their grain volume. There are literally thousands of them. Some are fairly large companies; but most are relatively small. Originating and terminating locations of even the largest of these companies are most often dependent on *one* railroad. Some trucking to market for short hauls (250 miles or less) works. But across vast stretches of the Plains States and elsewhere the great distances and volumes make grain trucking unrealistic, and not a source of effective competition to rail.

It should be noted that Class I railroads have created shortline spinoffs. Degrees of success vary. In our area the shortlines are service-oriented. Shippers like that. But due to physical connections and/or paper barriers, most shortlines do not provide competition to their parent Class I's. In many instances the Class I's set the rate and service parameters.

An important part of the message I want to leave with you today is that this imbalance of power has given the large railroads the economic clout to:

- dictate unreasonable terms and charges to small and large grain companies alike,
- charge exorbitant rates to captive grain shippers who have no effective legal remedy,
- devalue shipper investments through changes in rates and service offerings,
- determine which grain industry participants will survive and which will not,
- force change in marketing methods that would not otherwise occur,
- make or break markets,
- jeopardize our foreign markets through unusual rate-making schemes,
- influence land values by limiting the income that land can produce, and
- take advantage of farmers, agribusinesses like ours, and the general public, with little fear of someone stepping in to stop them.

We believe that where effective competition exists, it can govern railroad practices and prices. Unfortunately effective competition does not exist for thousands of grain shipper locations, and it has been slipping away in a macro-sense as railroad mergers have proceeded over the past 20 years.

USE OF MARKET POWER

Market power is demonstrated by extremely high grain rail rates for captive shippers. Many revenue to variable cost ratios on wheat movements from North Dakota and adjacent areas are in the 250–350 percent range (some up over 400), as compared to a jurisdictional threshold of 180 percent. These rates exhibit the plight of captive shippers. Documentation of these ratios can be found in testimony presented by the Upper Great Plains Transportation Institute of North Dakota State University to a hearing chaired by Senator Dorgan in Bismarck, ND on March 27, 2002.

Market power is also exhibited by railroad attempts to shape the grain marketing industry and domestic grain processing industry into fewer larger locations that fit the railroad's definition of efficiency. This goes beyond what would occur in a competitive environment. Incentives are offered to selected shippers to build and operate a 110-car loading facility at a location selected or approved by the railroad, and the industry must go along or risk being on the outside looking in. In my state and region the Burlington Northern Santa Fe is the dominant rail carrier. Its game plan in the grain business is promotion of a few big shippers primarily on its mainlines, with much less regard for the rest of its shipping and receiving customers who have made substantial investments to meet that railroad's previous demands. This has serious ramifications for farmers, grain elevators, rural communities and the entire region as grain gathering costs are shifted from the railroad to the public sector or others in the private sector. We can appreciate the need for efficiencies, but larger trains are often a mismatch with the diversity of crops produced and the increased number of quality segregations buyers want. It's like the proverbial square peg in a round hole. And when car cycle time gains for larger trains come partially at the expense of letting other sizes of train sit, then purported efficiency gains are exaggerated.

BNSF refuses to allow grain elevators on its lines to co-load 110 car trains, instead pushing for multimillion dollar investments in new facilities to serve this railroad's latest concept. Co-loading is two or more locations contributing loaded cars to a train. The other Class I railroad and all three shortlines serving North Dakota accept co-loading. According to the testimony of the Upper Great Plains Transportation Institute referenced above, this co-loading between two stations would cost the railroad only about $50 more per car (less than two cents per bushel), which could be reflected in a higher freight rate. That way the existing elevators could participate in the available business to a greater extent.

Market power is also demonstrated by other policies of railroads. Penalties for not loading railcars in the prescribed time, without a similar penalty on the railroad for untimely performance, is one example. Site lease charges and one-sided lease provisions are others.

Inverse Rates

An example of rail market power in the northern plains started about a year ago when BNSF set up secret inverse contract rates on wheat to the Pacific Northwest (PNW). "Inverse" means the shorter haul pays a higher rate. Western North Dakota and Montana rates to the Pacific Northwest were kept high, while rates for a selected few large 110-car shuttle train loading grain elevators in eastern North Dakota and western Minnesota were lowered. This disadvantaged other grain elevators in areas surrounding the selected few, and westward across North Dakota and Montana, with spillover effects on markets from South Dakota. Of course we support lower rates, but let's spread the benefit around and be equitable among shippers. This was an exercise in its monopoly power to select grain industry participants that the BNSF wanted to promote, while continuing to milk excessively high rates from more captive shippers and putting in jeopardy the investments of those and many of its other shippers.

This rate action jeopardized our foreign markets by shipping non-traditional grain into them. Wheat from traditional source areas in western North Dakota and Montana mills differently than wheat from spring wheat growing areas several hundred miles to the east. Complaints and concerns have come back from those foreign buyers. Bottom line is that unusual railroad rate actions can damage both shippers and markets.

Another effect of this BNSF inverse rate action was short-circuiting normal grain market forces. BNSF's stated reason for the rates was to maintain its market share of PNW exports in the face of drought-reduced crops in Montana. But there were millions of bushels of wheat in storage in Montana and western North Dakota when BNSF took these steps. Instead of the PNW market bidding up the price to get more wheat, the BNSF's inverse rate scheme held down or reduced grain prices for traditional farmer and country elevator suppliers. This is market manipulation. Meanwhile BNSF advocates free markets and noninterference by anyone in its pricing and practices. This is a double standard. Later in this statement I address the difficulties we encountered when we sought to consider a legal remedy for BNSF's actions.

These inverse rates distorted normal marketing patterns to the point that a farmer from western North Dakota actually hauled 50,000 bushels of wheat 160 miles *east* for loading on a train to move back *west* right past his normal delivery point 20 miles from his farm, that did not have the special rate. He reported driving approximately 16,000 miles to do this.

As of today the BNSF has discontinued these inverse rates. But BNSF CEO Matt Rose has left the door open to bringing them back.

NGFA

The National Grain and Feed Association is submitting written testimony for this hearing. NGFA expresses similar concerns over growing railroad market power and its implications on the marketplace. NGFA cites railroad demurrage charges ten times their car ownership costs. NGFA references costly penalties on shippers for nonperformance, without any penalty on the railroad or comparable compensation to the shipper when the railroad fails to perform. And can anyone justify a $200 per car penalty for a clerical error on a bill of lading? That's $10,000 in penalty for a 50-car train!

One NGFA example is of a shipper and his originating carrier agreeing on a reduced rate for a facility improvement making both parties more efficient. But when the connecting railroad to destination learned of this it raised its rail rates by the equivalent amount as rates were reduced by the originating carrier, thus extracting the entire rate benefit for itself. This clearly shows the market power railroads have to extract all additional revenues for their sole benefit.

Rate-Making

This same take-it-all rate-making approach was confirmed in testimony to a hearing chaired by Senator Dorgan in my state in March. A BNSF Ag Commodities VP said BNSF sets rates through the following process: "What we do as a rail transportation provider is look at the difference between value of the grain at the origin and value of the grain at destination, and try to determine the level of charges for transportation with margin for the elevators to operate and make money." The only reference is to how much the railroad can extract from the customers' margins and from the system. Only a monopolist can price that way.

The railroad attitude displayed to shippers who complain is horrible. In one instance in my state the president of the board of one cooperative elevator stated it had recently spent close to $2 million to upgrade its facility to meet what was then the BNSF's optimum train size. Then suddenly, because of the inverse rate given to a competitor, this elevator was losing business from part of its trade area. BNSF's Ag Commodities Vice President said this shipper was "a victim of its own poor planning". (Bismarck (ND) Tribune Feb 3, 2002)

Governors Speak Out

The situation with rail transportation in the northern plains is so serious that five governors recently wrote to the BNSF President and CEO about it. Attached to my testimony is the text of that May 10 letter initiated by North Dakota Governor John Hoeven and signed by governors from South Dakota, Montana, Nebraska and Wyoming. It cites excessive rates charged by a market dominant carrier, inverse rates, preferential rates for a few, effects on grain markets, communities, and highway infrastructure of the states.

About six weeks went by before our governor received any reply from BNSF. That itself says something about BNSF. When the reply came, it was not what we had hoped for. A portion of Governor Hoeven's public statement in response follows: "I regret BNSF's decision, and I pushed Mr. Moreland (BNSF Executive Vice President) to lower prices in western North Dakota, rather than raise them in the eastern part of the state. The railroad's decision, moreover, fails to address the larger, underlying problem, which is a lack of shipping competition in North Dakota. BNSF must create a level playing field, with reasonable rates for all producers, to ensure that farmers get a fair market price for their commodities.

"In addition, BNSF's action yesterday still fails to address the extreme rate differential between large and small shippers, which BNSF could partly remedy by making co-loading available to middle-sized shippers. BNSF's action will not cause us to step back from pursuing federal regulation and other measures that address a lack of competition in the grain-shipping railway industry. In the coming weeks, we will continue to explore all avenues to ensure that BNSF does not exploit its dominant position as the sole railway grain shipper in North Dakota to manipulate markets and grain prices. BNSF must respond to market forces, rather than distort them."

Alliance to Keep Rural America on Track

In November 2001 a group of agricultural organizations up our way formed the Alliance to Keep Rural America on Track. This includes our association, Farmers Union, Farm Bureau, all the major commodity promotion groups in our state, the rural electric and telephone cooperatives associations, insurance agents association, and more. The Alliance has members from other states as well. Purpose was and remains to raise public awareness of what railroad dominance means to farmers, grain elevators, and other businesses in both rural and urban settings, and to communicate our needs to the railroads from a broader platform. The involvement of farm and business groups demonstrates that what's going on with our railroads is of concern to more than grain elevator operators.

OVERSIGHT IS INADEQUATE

While these abuses go on, government oversight and protection, is ineffective. Complaint remedies, if you can even call them that, are havens for railroad lawyers to frustrate shipper interests with delays and expense. The railroad can drag out proceedings in the hope that the shipper will simply give up. Here are three examples.

The first example is the McCarty Farms grain rail rate case in Montana that went on for 17 years in front of the Interstate Commerce Commission and Surface Transportation Board before ending a few years ago with no payment to the aggrieved parties and no prescribed reduction in rates. At one time during this process the complainants had actually received a favorable ruling. Then the railroad lawyers went to work and stretched it out an additional 15 years. In the years immediately following enactment of the Staggers Act in 1980, it seems the ICC went out of its way to protect railroads instead of shippers.

The second example goes back to 1988 when some organizations and companies in the grain industry filed a complaint with the ICC against the Burlington Northern's Certificate of Transportation program. We went through a thorough discovery process. At one point the BN filed a motion for dismissal, which took the ICC many months to decide. It took four years to get an unfavorable ruling from the ICC in that case. A federal court later reversed portions of the ICC decision.

A third and continuing example is the Surface Transportation Board's attempt to eliminate product and geographic competition as factors to consider in the market dominance test. (A shipper must prove that a railroad is market dominant before the rail rate can be challenged.) The STB initiated this proceeding in April 1998 and decided to eliminate product and geographic competition in December 1998. The railroads quickly appealed. The DC Circuit Court of Appeals found for the STB, but remanded a portion back to the STB. When the STB issued its decision on that the railroads appealed again. That's where it stands today.

An extremely troublesome regulatory impediment to much of the grain industry in the Upper Great Plains is the absence of any adequate recourse for rates that appear to be unreasonably high. The Upper Great Plains Transportation Institute, an independent organization associated with North Dakota State University, calculates roughly that BNSF wheat rates from North Dakota range between 270 percent and 400 percent of variable costs. Virtually all of these wheat shipments originate from country elevators, which individually do not have the shipment volumes necessary to justify the million-plus dollars expense of a rate case under the so-called Stand-Alone-Cost (SAC) methodology commonly used by large volume, high density shippers such as coal-burning electric utilities.

Simplified Rate Procedures

The "simplified" procedures mandated by Congress are anything but simplified and do not solve the problem they were aimed at; the creation of a useable remedy for unreasonably high rates where the traffic volumes involved are not large enough to justify the huge expenditures necessary for a stand-alone cost case. Here are some of the reasons why the "simplified" procedures don't do the job.

As directed by Congress, the "simplified" procedures are not available to any small shipper for use in any rate complaint, but instead are only available for "determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case." This qualification led the STB to rule that, in each case where a shipper seeks to invoke the "simplified" procedures, there must be a showing that the case qualifies for treatment under the "simplified" rules. To make that showing, a shipper will have to retain experts who can prove that "a full stand-alone cost presentation is too costly, given the value of the case."

A "simplified" case cannot go forward unless there is a showing of "market dominance." The burden of proving "market dominance" is no different for a small volume shipper than for the largest coal-receiving shipper in the nation and will involve the use of cost consultants, attorneys, and discovery.

Use of the "simplified" methodology is far too complex to be attempted without lawyers and cost experts. The test involves the application of three "benchmarks." The first is known as RSAM and is intended to assess the extent of a carrier's revenue needs that can and should be recovered through differential pricing. The second component, known as R/VC > 180, is designed to measure the degree of differential pricing actually being practiced by that carrier. The third component is R/VC_{comp}. This benchmark measures the markup taken on traffic priced at more than 180 percent of variable cost that involves "similar commodities moving under similar transportation conditions." Data to meet the first of these two tests is published by the STB. The third test requires extensive discovery. The STB concedes that there "may well be some cases in which there is no readily identifiable traffic that is truly comparable." Thus, the ability of the shipper to even find data with which to satisfy the "simplified" test is questionable.

The outcome of a "simplified" case is uncertain even if the three benchmarks can be satisfied. Published STB data indicate that maximum rates prescribed under the first two benchmarks would be at approximately 230–250 percent of variable costs. Just how the $R/VC_{comp.}$ would impact that position has never been made clear by the STB.

I am by no means an expert on the "simplified" rules adopted by the STB, but I have been advised by cost consultants and others that the use of those rules is highly likely to result in a maximum rate prescription that is not below 230–250 percent of variable costs, depending on the railroad involved. By contrast, large, high density shippers, whose traffic volumes justify use of the expensive SAC cost method, have been successful in reducing their rates to a 180 percent of variable cost level. Small volume shippers accordingly appear to be relegated to a decidedly inferior status for the correction of unreasonably high rail rates if using the STB's "simplified" methodology.

Senator Dorgan asked Chairman Morgan about this problem, as appears in the attached correspondence. Her answer acknowledges the disparity between the type of rate remedy available to a large volume shipper as compared to that available to a small volume shipper. We suggest that this disparity needs to be corrected. There is no reason why a small volume shipper, shipping wheat over the same line of railroad that carries coal, for example, should be governed by a regulatory standard that virtually guarantees that the small volume shipper will pay 50 percent more than the large volume shipper, and we question whether that is what Congress intended.

Discriminatory Rates

There is also an inadequate remedy for unreasonably discriminatory rates. Before passage of the Staggers Act, inverse rates that favored some shippers over others might have been attacked under the anti-discriminatory provisions of the statute. The Staggers Act, however, made the anti-discrimination provisions absolutely inapplicable to "rail rates applicable to different routes." While the ICC might have interpreted that provision in any number of different ways, it chose the broadest interpretation possible, ruling in one case that rates that applied over the same line of railroad to neighboring communities were rates that applied over different "routes". STB Chairman Morgan, asked recently by Senator Dorgan to comment on the possibility of removing the "different route" prohibition so that railroads once again could be called upon to justify disparate rate treatment, suggested that such a statutory change might be "harmful" because it "might reduce the revenues flowing into the rail network." The text of the relevant exchange of correspondence between Senator Dorgan and Chairman Morgan is attached to my statement. We suggest, however, that it would not be in the least bit harmful to permit shippers to bring an unreasonable discrimination claim against disparate rates controlled by the same railroad so long as the railroad retains the ability to defend itself, as it could prior to Staggers. There is no need to altogether bar such claims from being brought.

POSSIBLE REMEDIES FOR CONGRESS AND THE STB TO CONSIDER

My organization and I personally are among those who believe strongly that effective competition not only is healthy economically, but far preferable to government regulation. However, when an industry has become characterized by excessive concentration of market power, some measure of regulation is necessary as a surrogate for competition. That was the theory of the Staggers Act. But today, it appears to us that the STB, and the ICC before it, is more focused on railroad economics than shipper economics. Many decisions have followed that track

During the last two decades, while STB policies endorsed the elimination of rail routes through mergers, they simultaneously were authorizing the accumulation of vast market power in the hands of a few railroads and the decline of competition, at least for the 30 percent or so of rail business that appears to be captive to rail service. Most of that 30 percent consists of bulk commodities, including grain.

Although railroads contend that they exist largely in a competitive environment and must be free to extract what the market will allow from their captive customers, we believe that Congress should not overlook the fact that railroads are, in effect, government franchisees who enjoy substantial benefits as a result of that status. Every STB approval of a railroad merger is, in effect, a government license or franchise, which carries with it valuable antitrust immunity unavailable to industries that are truly in the unregulated marketplace. Under present law, a railroad unilaterally, and with very limited notice, can impose new charges and terms on its customers through "tariff" publication—a prerogative available only to a franchised industry. The application of many state and even federal laws to railroads is preempted by the Interstate Commerce Commission Termination Act, narrowing their exposure for violations of the antitrust laws, or other activities that would be recognized as actionable under ordinary civil law. Railroads can implement their franchises through the right of eminent domain. Finally, at least some railroads currently are asking the government to use public money to subsidize railroad infrastructure projects.

Given the substantial market power now enjoyed by the remaining Class I railroads and the fact that they acquired that market power through government-issued franchises and exercise—dare I say abuse—it with the aid of government-bestowed regulations, we respectfully suggest that Congress should now act to make regulation the effective tool originally intended by the Staggers Act to moderate railroad excesses where competition does not do so. We suggest the following remedies for your consideration.

1. Adopt a resolution discouraging further mergers between Class I railroads and mandating that, in the event of any such mergers, necessary gateways must be kept open both physically and economically.
2. Legislate simplification of the market dominance standard, at least to the extent recently recognized by the STB in eliminating product and geographic competition as considerations.
3. Mandate "bottleneck" relief by requiring the monopoly carrier to quote rates on request to interchange points.
4. Simplify rate reasonableness proceedings for small volume shippers and eliminate the disadvantage apparently imposed on those shippers by the STB's "simplified" maximum rate rules (a disadvantage which Chairman Morgan seems to acknowledge). There is absolutely no reason why small volume shippers should bear a larger burden of rail deregulation than large volume shippers. If no other substantive standards can be devised under which rate complaints for small volume shippers can be simplified, then Congress should direct an appropriate government agency to develop an objective, reliable computerized version of stand-alone-costs adaptable in small volume rate cases for use by small volume shippers.
5. Consider granting shippers the option to utilize arbitration to resolve disputes with railroads, available with safeguards to insure that small volume shippers are not overwhelmed by railroad discovery requests.
6. Put the teeth back into the anti-discrimination provisions of the statute.
7. Require complaint case filing fees be kept within reach of shippers.
8. Visit the paper barriers issue as a possible way to create more competition.

This agenda must be started on soon. The clock is ticking on many shippers and segments of our industry as railroads flex their muscles. Railroads have the power to make or break shippers, receivers and, markets for what they see as gains for themselves. Once the economic landscape has been changed because of railroad actions not necessarily related to competitive economics, there is no turning back.

Mathew Rose,
President and Chief Executive Officer,
Burlington Northern Santa Fe Railway,
Fort Worth, TX.

Mr. Rose:

As governors of states with prominent agriculture industries, we urge the Burlington Northern Santa Fe Railway to find an equitable solution to its preferential grain shipping rates policy.

We recognize the importance of an efficient and vital rail shipping system; however, we believe that in some corridors BNSF is using its market dominance to charge excessive rates to captive shippers and to provide advantageous preferential rates to a handful of large-scale shippers. BNSF is also using its market power to impact grain markets by offering a discounted inverse rate for shippers that move grain greater distances. We request that your company immediately evaluate the negative consequences of selective grain shipping rates and commit to adjusting them.

Our states are not opposed to shuttle shipment of agriculture products; however, we ask that the rate spreads be consistent and equitable. Your current business practices have the potential to negatively impact grain markets and rural communities as smaller elevators struggle to compete. These practices also shift the burden of shipping the bulky commodities to the states' highway infrastructure, which contributes to road deterioration and distorts longstanding traditional grain movement patterns.

We ask BNSF to administer its pricing methods in a way that is fair to all of our railroad customers and grain elevators. In the absence of reasonable rate adjustments, we will have no other recourse but to look for alternatives that will provide equitable resolution of this issue, including support of federal regulatory intervention.

Signed,

JOHN HOEVEN,
Governor of North Dakota

JUDY MARTZ,
Governor of Montana

WILLIAM J. JANKLOW,
Governor of South Dakota

MIKE JOHANNS,
Governor of Nebraska

JIM GERINGER,
Governor of Wyoming

Hon. BYRON DORGAN,
United States Senate,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Dorgan:

You recently sent to me questions as a follow-up to the Senate Commerce Committee field hearing that you chaired in Bismarck, North Dakota, on March 27, 2002. For that hearing, I provided a written statement outlining the Board's jurisdiction over rail rates. Your questions relate to that written testimony.

Attached please find the responses to your questions. Do not hesitate to contact me if you need anything further.

Sincerely,

LINDA J. MORGAN,
Enclosures.

Question. The March 27 hearing focused to a large extent on the inverse export wheat rates of BSNF; that is, rates to the west coast which are lower from certain points in eastern North Dakota or western Minnesota than from points in western North Dakota or Montana, even though the rail line that carries the cheaper eastern wheat passes through the communities, or over main lines just a short distance from the communities, where there is wheat that could have been shipped to the west coast but for the inverse rate structure.

Your testimony points out that "current law . . .prohibits unreasonable discrimination (49 U.S.C. 10741), but the prohibition does not apply to the cancellation of joint rates, rail rates applicable to different routes, or different rates that result from different services," and you observe: "Shippers have not made substantial use of the anti-discrimination prohibition in litigation before the Board."

A. Do you think that the anti-discrimination provision was or is available to wheat shippers who believe they were injured by the BNSF inverse rates in North Dakota?

B. Would the inapplicability of that remedy to "different routes" be likely to defeat a discrimination claim?

C. If you think the answer to the latter question is affirmative, then, where all of the rates and routes involved are under the control of the same carrier, would you see any substantial harm in changing section 10741 so that it would be inapplicable to different carriers, rather than different routes, bearing in mind that the defendant carrier could still defend by arguing that the rate disparity was due either to different services provided under the different rates, or for performing services that are not "like and contemporaneous" or applicable under "substantially similar circumstances"?

Answer. I am not in a position to attempt a definitive answer to the first two parts of your question, as it could prejudge an issue that could come before the Board in a formal proceeding. However, it is virtually certain that, if such a complaint were brought, the railroad would raise as a defense the argument that the anti-discrimination remedy is expressly precluded by the statute because the services at issue involve different routes. That, I suspect, is why a formal complaint has not been brought before the agency by North Dakota wheat shippers.

Changing the statute by repealing the categorical exclusion of a discrimination remedy for services over different routes, as you suggest in the third part of your question, would not completely foreclose a carrier from defending itself in a discrimination case: a carrier could still prevail by showing that the services or circumstances at issue are not similar, and thus that the different rate treatment is not unlawful. Whether or not such a statutory change would be harmful depends upon the interest that is being considered. The existing statutory scheme reflects a delicate balance of competing interests. Certain statutory changes could upset that balance, and could restrict the ability of rail carriers to respond to market forces. This, in the long run, might reduce the revenues flowing into the rail network to cover capital needs and have a negative effect on the service to be provided overall.

Question. Your testimony also reviews the methods available for challenging unreasonably high rail rates. You observe that there is a "simplified, alternative procedure" but that it has not been used and that rail customers remain concerned that even the simplified procedure is still too burdensome. You note that, to "address this continuing concern, the Board recently issued a decision seeking comments on the idea of legislation mandating the use of arbitration to resolve these small rate cases."

As you know, one of the criticisms leveled at the "simplified" procedure is that the three "benchmarks" it relies upon appear destined to produce a maximum reasonable rate well in excess of 200-percent of variable cost—some say in the vicinity of 240-percent of variable cost—while the stand-alone methodology, utilized in large volume cases, is capable of achieving a maximum rate as low as 180-percent of variable cost.

A. Do you agree that the simplified methodology is likely to result in a maximum rate that is higher than 200-percent of variable costs or, in general, higher than the lowest maximum reasonable rate obtainable under the stand-alone methodology? If so, why should one of the Board's recognized rate case methodologies be more likely to produce a higher maximum reasonable rate than the other methodology?

B. If an arbitration system either relies on or allows the use of existing maximum rate case methodologies, won't arbitration virtually compel shippers in cases suitable for arbitration to engage in the costly proofs required under the Board's litigation methodologies or run the risk of being overwhelmed by railroad arbitration presentations that rely on approved methodologies?

Answer. The simplified maximum rail rate procedure, like the stand-alone cost (SAC) methodology, was designed to give effect to all of the considerations that the statute directs the agency to consider in rail rate cases. As we do not have much experience in applying the simplified guidelines, I cannot project the range of results that the methodology would likely produce. But even if the simplified methodology did produce ratios above 180-percent, comparing a small rail rate case to a case involving high-density rail movements of a commodity such as coal does not seem to me to be a valid exercise. The stand-alone methodology is designed to determine the lowest cost at which a hypothetical, efficient railroad could provide the transportation service needed by the complaining shipper. High-density coal movements, which have been the subject of most of the SAC cases handled by the agency, tend to produce efficiencies of scale that in many cases would not likely be generated by the traffic associated with a small rate case. Thus, under the economic principles underlying the statute that the Board administers, it would not be surprising or inappropriate if the rates set in a coal case were lower than those that would be set if the SAC methodology were applied to the traffic involved in a small rate complaint.

Although we do not believe that the small rail rate case process need be particularly burdensome, it is true that an arbitration system based on SAC could involve elaborate presentations comparable to those currently made before the Board. With this concern in mind, if Congress decided to adopt an arbitration remedy, it could prescribe a standard other than those currently used by the Board. If it proceeds along those lines, however, whatever standard or approach is adopted should recognize that most railroad traffic is competitive, and that if rates on captive traffic are held down too far, carriers will not be able to meet their capital needs or make appropriate investments in their facilities.

NATIONAL GRAIN AND FEED ASSOCIATION
July 26, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Re: *July 31, 2002 Subcommittee Hearing on Railroad and Shipper Concerns*

Dear Chairman Breaux:

This letter is being sent to you and to the Members of the Subcommittee on Surface Transportation and Merchant Marine in advance of the hearing scheduled for July 31 on railroad and shipper concerns before that Subcommittee. The National Grain and Feed Association (NGFA) was not invited to testify at that hearing, as a grain industry witness had been previously invited. We respectfully request that this letter be made part of the record in that hearing, and hopefully it will provide the Members of the Subcommittee information about the rail marketplace and aspects of it that concern our Members. We appreciate your efforts to pursue commercially reasonable solutions to rail customer concerns.

The National Grain and Feed Association is the national voluntary trade association comprised of 1,000 member companies involved in grain buying, warehousing, merchandising, feed manufacturing, livestock feeding, grain processing, and exporting. Our members include privately owned, public corporations and farmer-owned cooperatives. Companies in our membership range from the largest bulk handlers and processors in the U.S. to relatively small country elevator and feed mill operations. We have about 400 companies in our membership that are active rail shippers or receivers.

The grain industry has continuing concerns with the concentration of market power among the major rail carriers, and its impact on the marketplace, in particular the effect it is having on the business relationship between railroads and their customers and the potential long-term implications for both.

Why can railroads treat their customers differently than other service providers? Quite simply, the structure of the market and the market power that is wielded by carriers—at least in the short run—permits non-competitive and uneconomic charges and creates impediments to competition-driven enhancements in market efficiency. In the long-run such behavior is damaging to both railroads and their customers, as any railroad customer that can ultimately find a different way (other than rail) to access a market, or find a new place to locate a plant where acceptable competitive business service is provided, will actively seek such solutions.

Examples of railroad policies and approaches that are costly, often counterproductive, and that are made possible by limited competition (and are not generally seen in any other customer-supplier relationship in other industries) include:

Example 1. One U.S. railroad charges almost $200 per car if a mistake is made on an electronic bill of lading. So, if the shipper transposes two numbers in a bill of lading generated at origin on a 50-car unit, the railroad has the right to bill the shipper about $10,000. This absurdly high penalty for clerical errors may work counterproductively by encouraging the shipper to return to a less-efficient operation by generating a hand-written bill and letting the railroad employee then generate the electronic bill, forcing the railroad to spend more of its resources. This way, if a mistake occurred, the shipper would not face such a steep penalty. We know of no other situation in the private sector analogous to such punitive business practices forced by the service provider on its customer base, particularly in situations where the customer is accommodating the business practices of the service provider by generating an electronic bill of lading.

Example 2. Lease rates for certain types of rail cars are around $200 per month or less in today's market, or under *$7 per day.* Yet, some railroads are assessing demurrage rates at *$75 per day* for such equipment! While demurrage is intended in part to be a disincentive for inefficient performance, it is also intended to reflect car ownership costs. There should be *some* relationship between car values and the demurrage charges that are intended to improve efficiency by reducing effective cycle times between loading and unloading. Such wide differences exist because the supplier is dictating business terms in a non-competitive market. In a competitive market, alternatives would quickly evolve that would not allow such huge rate "spreads" between demurrage and car lease rates to exist.

Railroads are tightening demurrage terms and raising demurrage rates ostensibly to boost shipper performance. However, if the carrier fails to perform, i.e., show up within the prescribed time frame or fails to meet schedules that force a plant to shut down, there is no penalty or comparable compensation available to the shipper. While railroads in general have improved their on-time performance, one rail-dependent processor reports that since January 2002 one carrier has only been able to place 59-percent of shipments at destination within a 72-hour window. Of course, no penalty applies to non-performance by the railroad, so there is little pressure for the railroad to improve. This kind of performance makes it difficult to manage a rail-dependent business. It is particularly frustrating when shippers are required to pay demurrage or storage charges for what the railroad calls "excess" shipper-controlled railcars being online. This is another clear example of rail market power, which contributes to impediments to further gains in market efficiency. In the short-run, the railroads can get by with this performance, and dictate terms. However, in the long-term it will damage their economic prospects.

Virtually all tank cars in the agricultural market are either owned or leased by shippers, because the railroads refuse to supply such cars to soy oil or corn syrup manufacturers. These processors must have an adequate number of empty tank cars located at the facility to ensure the ability to continue processing, and to manage the uncertainty caused by railroad performance inconsistencies. In today's market, some rail carriers want the shipper to pay $25 per car per day in "storage" charges to have the privilege of having empty tank cars on their line while waiting to load at a plant. Negotiations with the carriers have failed to produce any workable solution. Not only have the railroads been able to force the shipper to bear the cost of their inefficiencies and inconsistent performance by forcing shippers to buy or lease more rail cars than would be needed if the railroads performed; now there is an effort to extract additional revenues on what the railroads deem as "surplus" cars—leased cars that allow the shipper to ensure that plants can operate without interruption. This is another clear example that the rail car marketplace is anything but a reasonably competitive market. The rules of that market are controlled and dictated by the carriers and the rules can and are changed precipitously in ways that shippers' car investments are quickly and unpredictably devalued.

Example 3. The market power of railroads to unilaterally define market outcomes can be observed in their ratemaking as well. In one recent example reported by an NGFA member, a shipper and originating rail carrier agreed that the shipper would upgrade his facility for the benefit of both the shipper and railroad. And, for that agreement, the originating railroad agreed to provide a rate incentive for a period of time that would partially compensate the shipper for the investment. Shortly after the investment was made, the connecting railroad raised its rail rates by the equivalent amount of the rate incentive provided by the originating carrier, thus extracting the entire rate benefit for itself (and leaving the shipper with no revenue stream to use in paying for the improvement). How could the connecting carrier do this? Because it has the unfettered market power to extract all additional revenues for its sole benefit, even though such action is clearly destructive to long term customer relationships and the desire to improve facilities to encourage greater use of railroads.

Example 4. Credit terms of railroads are generally tighter than any other service provider known to our industry and the terms are entirely one-sided. In the not-too-distant past, after a shipment was unloaded at destination, a freight bill was cut and mailed to the customer, who then had 15 days from the mailing date to pay the bill. (Of course, most service providers bill *after* service is provided, but 30-days net is a more common receivables policy.) Today, railroads cut a freight bill as soon as a car is loaded at origin, and a freight bill is delivered electronically to the customer within hours after a shipment is loaded. Payment must be received in 15 days or is subject to penalties and interest. Thus, payment can be due prior to even completion of the shipment. While the payment terms are tighter than seen in any other industries, another enormous difficulty is that many rail bills contain errors forcing shippers to spend many man-hours auditing the invoices for mistakes. Industry companies report that between 10-percent and 50-percent (depending on railroad and reporting rail customer) of all rail invoices received contain errors. This auditing process requires time and money.

If interest charges apply on a bill, railroads have been known to invoice for amounts less than 15 cents on a bill. If a shipper claim is submitted to a railroad in which the railroad owes the shipper money (often for long periods of time), the carriers refuse to recognize *any* interest charges that apply. As for claims for damaged goods that might be submitted by shippers to railroads, some rail carriers refuse to even consider claims for less than $35 per car. The imbalance in credit terms and other terms of service is a reflection of an imbalance in market power between the railroad and its customer base.

Example 5. The ability of railroads to use market power to dictate terms is also being felt by customers that own or lease railcars. When railroads utilize *customer-owned or leased rail cars* to carry product, they compensate the customer through "mileage allowances," which are intended to compensate for investment and maintenance costs to keep the car in service. When railroads operate *cars owned by other railroads* on their track, there are arrangements for "car hire" (rental paid by one railroad to another for freight cars, the conceptual equivalent of private car mileage allowances). In 1992, railroads agreed to "de-prescribe" car hire charges for railroad-owned cars and phase such de-prescription in over 10 years. The car hire rate was frozen at the 1990 rate, but 10-percent of the existing fleet each year could be de-prescribed by car owners and all new or rebuilt cars were de-prescribed, allowing car hire rates on those de-prescribed cars to then "float" with the market. The market in this case is one where the carriers mutually agree on a rate, and since large carriers are in a position that either could be a "net" seller or "net" buyer in a given period of time, there is incentive for both to establish a fair market price.

One major railroad recently announced substantial reductions in the mileage allowances paid to shippers who furnish their own cars. In many cases, these private cars had been purchased or acquired under long-term leases. The reduced mileage allowances will shrink revenue well below the investment cost for the entire fleet of cars owned or leased by the customer. While the railroads collectively understand their need to phase in such significant changes to avoid market disruption on their cars, the railroad making this particular change gave 5 months' notice to its customer base. Is it unreasonable for the rail customer to expect to be treated no worse than its railroad treats its own competing carriers?

Example 6. As the U.S. railroad industry has evolved to be dominated by a few major players, carriers have developed rate and service structures designed to keep as much traffic moving on their own line as possible. There are, however, instances in which a given shipper can reach a small percentage of its customers via either of the two regional rail systems. Shippers report that, to a growing extent, what they face when they attempt to avail themselves of this limited competition is retaliation by the railroad that had been receiving all the traffic. A carrier whose "competitive" traffic is diverted to the second carrier raises the rates on its remaining captive traffic to recoup the diverted revenue. When both carriers in a duopolistic market behave in this manner, price competition is nullified.

We appreciate the opportunity to submit our views to the Subcommittee. We would be pleased to respond to any follow-up questions.

Sincerely yours,

KENDELL W. KEITH,
President.

Senator ROCKEFELLER. Thank you, Mr. Strege. I would like to call now on Mr. Charles Platz, who is president of Basell North America in Wilmington, Delaware.

STATEMENT OF CHARLES E. PLATZ, PRESIDENT, BASELL NORTH AMERICA INC.

Mr. PLATZ. Thank you, Senators. Good morning. My name is Charles Platz, and I am the president of Basell North America. I also serve on the board of directors of the American Chemistry Council, and I in fact had letters from many of my colleagues supporting my testimony. I would like to have them included in the record, if possible.

Senator ROCKEFELLER. It will be done.

Mr. PLATZ. Thank you.

We have operations in Louisiana at both Lake Charles and at Taft, and I am also pleased to say that Mr. Dan Borne, president of the Louisiana Chemical Association is also here today. Besides Louisiana, Basell has production facilities in Bayport, Texas, and Jackson, Tennessee. By the way, our plastic products go into almost every consumer application, from medical to automotive.

I am here today because safe and efficient rail service is vital to the business of chemistry. In fact, a strong, healthy railroad industry is critical to our success. That is why we strongly support the efforts of this Committee and this Congress to provide the necessary Federal resources to improve the Nation's rail infrastructure. However, competition between railroads is just as critical. With transportation representing such a large portion of our production costs, and as an example, at Basell is second only to feedstock, the existing lack of competition has a detrimental effect on our competitiveness.

Nearly two-thirds of our industry's production facilities which rely on rail service are captive to one railroad, and therefore lack competitive price quotations and service options. At these captive sites, freight costs average 15 to 60 percent higher than freight costs at non-captive facilities. Unfortunately, the regulatory scheme that has evolved all but removed any incentive for railroads to respond to the concerns of captive customers. To make matters worse, the remedy process established at the STB has proved inadequate to protect captive rail customers.

Regulatory decisions have led to what amounts to monopolistic behavior which is not tolerated in other industries, and tolerating such behavior in the rail freight industry simply runs counter to the principles of a free market economy. Only Congress can resolve the problems faced by rail shippers who lack competitive service. We urgently request your help in remedying the situation and restoring the competitive balance envisioned by the existing Federal law.

Now allow me to tell you how the lack of competitive rail service affects Basell. Basell depends on rail service to meet the needs of our customers around the country. We have invested in a fleet of rail cars valued at nearly $1/4 billion to serve these customers. This investment truly binds us to rail service. Basell's Lake Charles and Bayport facilities load their entire production directly into rail cars. These facilities are only 135 miles apart, and ship product to destinations with comparable lengths of haul. Lake Charles is not captive, and is served by three railroads. Bayport is served by only one carrier, and it is captive.

Basell's costs at Bayport are consistently higher than at Lake Charles. In fact, the railroad serving our Bayport facility linked its prices for that business to our Lake Charles plant. In other words, Basell's only one practical way to reduce monopoly costs at our captive Bayport facility was to commit the shipments out of the non-captive Lake Charles site to the same railroad serving Bayport.

The railroads call this practice bundling, yet in reality this practice draws on the power over a captive site that leveraged non-captive facilities in different locations.

At great risk, Basell recently switched carriers at its Lake Charles facility. This action improved costs and service at Lake Charles. However, at Bayport Basell faced increased cost, reduced service, and an escalating adversarial customer-supplier relationship.

Like many rail customers, Basell loads product directly into rail cars which are then stored with rail carriers prior to shipment. In the last 2 years, Basell's costs to store cars loaded at the captive Bayport facility increased some 375 percent, while Basell's storage costs at the non-captive Lake Charles site decreased. Amazingly, rail carriers will not entertain service-level commitments in contracts with captive customers, while they will do so for non-captive customers. Basell is caught in a really strange and strained relationship. Even though we pay more as a captive shipper, we are not treated as a valued customer, although what I just described here and in my written testimony is the net result of the existing regulatory environment.

In closing, I would like to touch on action recently taken by Basell to become non-captive at its Bayport site. Basell joined with three other chemical companies in Bayport and a competing railroad to seek regulatory authority to construct an alternative rail line. That application is pending with the STB, and I will not address any of the specifics today. However, this project will liberate Bayport from captivity, and at the same time leverage Lake Charles.

I would say, however, buildouts are not viable for most situations. Rail customers should not be forced to involve themselves in the business of railroading as the only means to create rail competition. Unfortunately, these investments are necessary under the existing regulatory environment. This was not intended by the Staggers Act, and points to the urgent need for Congress to restore balance to the regulatory process.

Senators, I again want to thank you for the time and attention you are giving this important issue. We urgently request that you address rail competition through appropriate legislation as soon as possible, and we stand ready to assist you. Thank you.

[The prepared statement of Mr. Platz follows:]

PREPARED STATEMENT OF CHARLES E. PLATZ, PRESIDENT, BASELL NORTH AMERICA INC.

EXECUTIVE SUMMARY

Safe and efficient rail service is vital for the member companies of the American Chemistry Council ("the Council"). In fact, a strong and healthy railroad industry is critical to the success and competitiveness of the chemical industry. That is why we strongly support the efforts of this Committee and this Congress to provide the necessary federal resources to improve the nation's rail infrastructure. Competition between railroads, however, is just as critical, and the lack of competitive rail service options has a serious and detrimental affect on the chemical industry's ability to compete in a global marketplace.

The business of chemistry is second only to the nation's electric utilities in terms of its dependence on railroads and the size of its rail freight bill. Chemicals and plastics annually account for $5 billion in rail service provider revenues paid to transport 150 million tons of rail freight into virtually every sector of the American economy, Canada, Mexico and to various U.S. ports for export worldwide.

Nearly two-thirds (63-percent) of our industry's rail-served production facilities are captive to one railroad and lack competitive price quotations and service options. At captive sites, freight rates are 15-percent to 60-percent higher than freight rates at competitively served facilities, and decisions by the Surface Transportation Board ("STB") have essentially removed any incentive for railroads to respond to customer service concerns. Captivity similarly impacts solely served customer freight destinations. To make matters worse, the processes established by STB to protect captive rail shippers have proven to be inadequate. Such monopolistic behavior would not, and is not, tolerated in any other industry, and should not be tolerable in the freight rail industry. It simply runs counter to the principles of a free-market economy.

Only Congress can resolve the problems faced by rail shippers who lack competitive service, and the chemical industry urgently requests your help.

Mergers approved by STB have left the only two major carriers in the East and two in the West. Due to captivity, however, even the existence of more than one railroad in a region does not provide competition. It is clear, therefore, that the process by which rail mergers are reviewed and approved must be enhanced to safeguard against further erosion of competition between rail carriers.

On top of the diminished competition from merger approvals, certain other regulatory decisions have frustrated measures wisely enacted by Congress to correct competitive imbalances. These decisions impact important aspects of the rail industry's relations with its customers and must be examined. For example:

- The STB has essentially precluded captive shippers from having their cars "switched" to other carriers at interchange points in terminal areas.
- The STB's "bottleneck" doctrine effectively blocks competition even where two railroads could each provide service over a portion of a longer route.
- The exclusive forum to determine "rate reasonableness" is fraught with administrative and regulatory barriers that paralyze the process and deprive captive rail customers of the protection afforded by statute.

In conclusion, because the business of chemistry depends so heavily on railroads, we urge the Senate to promote the long-term health of the nation's railroads. We support improvements in our rail infrastructure. Equally important—as envisioned in the Staggers Rail Act of 1980—we must allow free-market forces to operate in a truly competitive manner in the railroad industry.

STATEMENT

Good morning, Mr. Chairman and Members of the Surface Transportation and Merchant Marine Subcommittee. My name is Charles E. Platz, and I am the President of Basell North America Inc. ("Basell"). My business address is 2801 Centerville Road, Wilmington, Delaware 19808–1609. I serve on the Board of Directors of the American Chemistry Council ("the Council") and I am representing the Council here today.

As you know, Mr. Chairman, Basell is a proud corporate citizen of Louisiana, with production facilities in Lake Charles and Taft. I am pleased that Mr. Dan Borne, who is the president of the Louisiana Chemical Association, is accompanying me today.

Basell also produces or compounds plastics at facilities in Bayport, Texas, and Jackson, Tennessee.

Illustrating our company's dependence on rail transportation is the fact that 100-percent of the polymer resins we produce at Lake Charles and Bayport are loaded directly into railroad hopper cars. These operations account for the vast majority of our U.S. production. Rail is the preferred mode for shipping our product. Truck transportation is not a viable alternative. To meet the needs of our customers around the country, Basell has invested in a fleet of more than 4,000 hopper cars. Please note that Basell's entire fleet of hopper cars, which has a replacement value exceeding $260 million, is not supplied by the railroads. Instead, like many other rail shippers, Basell must provide its own specialized equipment by purchasing and/or leasing railcars.

The American Chemistry Council represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make people's lives better, healthier and safer. Chemicals are essential to the production of virtually every product that consumers use—computers, medicines, automobiles, cell phones, fabrics, etc. The Council is committed to improved environmental, health and safety performance through Responsible Care®, common sense advocacy designed to address major public policy issues, and health and environmental research and product testing. The business of chemistry is a $450 billion enterprise and a key element of the nation's economy. It is the nation's largest exporter, accounting for ten cents out of every dollar in U.S. exports. Chemistry companies invest more in research and development than any other business sector.

Safe and efficient rail service is crucial for the Council's member companies. For the railroads, as with every industry, competition is the key to performance. The business of chemistry is second only to the nation's electric utilities in terms of its dependence on the U.S. railroad system and the size of its rail freight bill. Chemicals and plastics annually account for 150 million tons of rail traffic, which provides the railroad industry with $5 billion in freight revenues.

On behalf of Basell and the Council, I appreciate the opportunity to address several important issues regarding the relationship between the railroads and their customers. Because Federal law governs this relationship, the Council appreciates the Subcommittee's examination of the difficulties that "captive" rail customers face on a daily basis. It is unfortunate that in a number of industries there are rail-dependent companies whose business is essentially captive to—or, if you will, monopolized by—their rail carriers. Basell is one of those companies. Today I have brought with me a number of letters from other companies engaged in the business of chemistry. Those letters are attached to this statement and I request that the Subcommittee include this correspondence in its hearing records.

Over the past several years the Council—on behalf of its members—has become increasingly concerned about the lack of direct head-to-head competition between railroads. (When two railroads compete against each other for business at a specific shipping or receiving location, it is sometimes called "rail-to-rail" competition.) But in actuality rail-to-rail competition occurs too rarely. For the Council's membership as a whole, 63-percent of all rail-served chemical plants in the United States are restricted to service by a single railroad. In other words, when it comes to rail transportation, nearly two-thirds of our industry is "captive" and therefore has no opportunity to obtain competitive price quotations and service options. The Council's member companies reported that their freight rates are much higher (ranging from 15-percent to 60-percent more) where one railroad has a monopoly over the shipper's traffic than where there is competition between railroads. Nor is it surprising that the Council's members find rail carriers to be less responsive to customer service concerns at the many plant locations that do not have rail-to-rail competition. In fact, in our free-market economy, competition is what drives consistent and reliable service in any industry.

I am here today because this lack of competitive rail service is damaging to the business of chemistry and increases costs to the American public. In fact, at Basell, rail transportation is our second largest cost (after feedstocks). The chemical industry's customers participate in virtually every sector of the U.S. economy—including motor vehicles, pharmaceuticals, computers, packaging, agriculture, and water treatment. We are under constant competitive pressure to supply them with our products on a cost-effective and timely basis. Moreover, as the nation's largest exporting industry, the business of chemistry also had to arrange for the movement of more than $80 billion worth of exports last year. Competing in export markets often requires rail service, either to reach customers in Canada and Mexico or to move products efficiently to various U.S. ports.

I have underscored the importance of rail service to the business of chemistry. I would now like to explain the impact of the lack of competition between railroads at so many specific locations. Some shippers face captivity where their traffic is picked up by the railroad (e.g., chemical plant, coal mine, grain elevator). For others, one railroad has a monopoly hold on the delivery point (chemical customer, electric power plant, grain processor). In many cases a specific rail movement is captive at both its origin and its destination. Even if only one end of the rail movement lacks an alternative rail service provider, competition will be affected. For example, Basell's production site is served by more than one railroad in Lake Charles. But if a particular shipment is to be delivered to one of our customers at a point that is captive to one of those railroads, in virtually no case can another railroad bid for that traffic.

In this regard, it is important to note that a captive shipper's difficulties are not alleviated if another of its own facilities is served by two competing railroads. Nor does the fact that some shippers use trucks or barges to move certain chemical products, for which those modes of transportation are feasible, somehow offset captivity for other rail-dependent shippers. To the contrary, as I will explain with reference to Basell's operations, a company with a captive production facility can even lose the benefits of the competition that exists elsewhere.

Basell is not captive at Lake Charles. But one of the railroads at that location does have a monopoly on rail service at Basell's Bayport, Texas, facility. That railroad uses its market power to obtain leverage over our Lake Charles traffic. Because of this situation, Basell and three other shippers have joined with another railroad to create competition in Bayport. We have applied to STB for permission to build and operate San Jacinto Rail Limited, a partnership whose mission is to introduce and provide competitively priced rail-service options that are sensitive to public safety and the environment. (That application is pending.) Although my company would prefer to invest in plastic resin production facilities rather than rail assets, current regulatory policies compel us to do so.

Let us begin by recognizing that such unbalanced competitive conditions were not envisioned when Congress passed the Staggers Rail Act of 1980. Indeed, that landmark legislation struck a careful balance between the needs of the railroads and the interests their customers. On paper, the law retains that balance. But two decades of regulatory decisions, first by STB's predecessor agency (the Interstate Commerce Commission) and subsequently by STB itself, have severely tilted the scales.

The Council is acutely aware that STB's exclusive authority to review rail industry mergers has left this country with so few railroads that there are now only two major railroads in the East and two in the West. As I noted earlier, the reality is that nearly two-thirds of all rail-served chemical production facilities have no competing rail service, even when another railroad has tracks within a few miles—or even closer. If the trend continues, the next round of rail mergers will almost certainly trigger successive transactions, resulting in an industry with only two major railroads in North America. With its members already subject to monopoly conditions at so many of their rail-served production facilities, the Council anticipates that the "rail merger end-game" will result in an even greater level of concentration and therefore even fewer alternatives for captive shippers.

Ideally, the next-and-likely-final round of rail mergers should be reviewed from an antitrust perspective. The Council therefore urges the Senate to elevate the involvement of the U.S. Department of Justice in the approval of rail mergers, and to make that change before further mergers are announced. Given the extreme concentration that already exists in the rail industry and the market power that railroads exert over individual captive shippers, it would certainly be appropriate to give more authority to an agency with a more balanced view of competition.

Turning from merger policy, I would like to comment on STB's governance of the on-going relationships between railroads and their customers. This is not a new topic. In fact, the laws that established STB recognize that there will inevitably be some captive rail freight customers. For that reason, Congress provided several methods to correct competitive imbalances. However, over two decades since passage of the Staggers Act, a series of agency-imposed policies have greatly weakened such provisions. Allow me to touch on just three important examples:

- *Terminal Access*. Some captive shipper facilities are located in "terminal areas," where two or more separate railroads maintain tracks and interchange traffic. The law (in this case, 49 U.S.C. Section 11102) permits a customer that is located in a terminal area but is captive to Railroad A to seek STB's approval to arrange for Railroad B to provide competitive long-haul service. One way to accomplish this is for the captive shipper's freight cars to be "switched" by Railroad A (the monopoly carrier) to Railroad B (the other carrier with facilities in that terminal area). Railroads regularly switch cars within terminal areas, but they oppose the use of switching as a pro-competitive alternative for captive shippers. STB, following the precedent set in the Interstate Commerce Commission's "Midtec Paper Corp." decision in 1986, has never granted captive shippers the type of competitive service that is clearly contemplated in this existing statutory remedy.
- *Bottleneck Rates*. Another form of relief that has been denied involves what are known as "bottleneck" situations. Captive shippers have asked Railroad C, the exclusive service provider on the monopolized portion of a rail route, to quote a rate for that specific portion only. The shipper's objective is to benefit from the competition that exists between Railroad C and Railroad D over the remaining—competitive—portion of the complete movement from origin to destination. Several years ago, STB examined this matter in a series of "bottleneck" cases. (The bottleneck is the monopolized portion of the route, which may be a small fraction of the total distance.) While nothing in the statute explicitly prevents STB from requiring Railroad C to offer a rate for its bottleneck portion of a movement, the agency has consistently refused to do so. (STB's only exception is to require Railroad C to provide a bottleneck rate in the virtually non-existent situation where the captive shipper has previously signed a rail service contract with Railroad D covering the remaining competitive portion of the move-

ment.) Again regulators interpreted the law in a way that denies captive shippers another form of competition.

- *STB "Rate Reasonableness" Procedures*. Finally, the law establishes STB as the exclusive forum to resolve commercial issues arising in the rail industry. This includes STB's authorization to adjudicate the "reasonableness" of rates paid by captive rail customers. (See 49 U.S.C. Chapter 107.) A shipper must first clear a series of evidentiary hurdles to demonstrate that it is truly captive (this is known in the statute and regulations as finding that the railroad has "market dominance" for that shipper's rail traffic). Then STB is to decide the maximum reasonable rate that the captive shipper must pay to the market-dominant railroad. In reality, however, this process is vastly different than one would expect, as shown in a 1999 study by the General Accounting Office ("GAO"). STB's process actually deters shippers from using the only forum provided by Congress. GAO surveyed shippers of grain, coal, chemicals and plastics. Among the barriers identified by GAO were: STB's filing fee (raised to $61,400 as of April 8, 2002); the additional costs of lawyers and consultants; the complexity of STB's procedures; the fear of reprisal by the railroad; etc. Perhaps most telling is that 69-percent of the shippers surveyed by GAO believed that "STB will most likely decide on behalf of the railroads, so it is not worth our effort to file a complaint." ("Railroad Regulation: Current Issues Associated with the Rate Review Process," GAO/RCED–99–46, pages 47–51).

Basell ships approximately 14,000 carloads of plastic pellets per year. I can state that none of these three approaches—neither terminal access, nor bottleneck rates, nor STB "rate reasonableness" procedure—provide Basell with any opportunity to offset the effects of rail captivity. But in Canada, where my company also produces plastic resins and faces similar transportation circumstances, there are meaningful ways for captive shippers to negotiate with their rail service providers on a more level basis. While the Council stands ready to provide examples if the Subcommittee is interested, all I need to say today is that Canada—which is a two-railroad country—provides fair and workable mechanisms that address each of the three elements that I have just described.

In conclusion, the American Chemistry Council thanks the Surface Transportation and Merchant Marine Subcommittee for the opportunity to participate in today's hearing. Because our members depend so heavily on the railroads, we urge the Senate to pass legislation that would promote the long-term health of the nation's railroads—as envisioned in the Staggers Rail Act of 1980—by allowing free-market forces to operate in a truly competitive manner.

The business of chemistry needs and supports a strong rail industry. In our view, the nation's rail infrastructure needs to be upgraded to carry our products and those of other critical sectors of the economy. We also applaud Senators who have already introduced or co-sponsored pro-competitive rail legislation. We look forward to working with others in Congress to re-establish the appropriate balance on the issue of rail-to-rail competition. Finally, we strongly and urgently request that this Committee address rail competition by clarifying STB's role through legislation as soon as possible.

Thank you for your interest and attention. I would be glad to answer any questions.

AKZO NOBEL,
Chicago IL, July 31, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

Thank you for holding today's hearing to address the competition and service concerns of rail shippers. This provides the industry with an important opportunity to address longstanding and growing problems faced by shippers who receive their service from only one railroad.

Rail industry consolidation has decreased competition, diminished service, and above all significantly increased transportation costs for *captive* rail shippers. Unfortunately, the Surface Transportation Board (STB) has shown that it is unable to adequately and reasonably address these problems. We, therefore, believe congressional action is necessary to increase the competitive transportation options for captive rail shippers and to ensure the processes at the STB for protecting captive rail shippers are workable.

Illuminating our concerns is the recent renewal of a Norfolk Southern Railroad/ Akzo Nobel Chemicals Inc. transportation contract. The contract covers shipment of Sulfuric Acid by shipper owned tank car to two separate locations for one of our customers. Both sites are also captive to the Norfolk Southern. We requested that the contract be renewed for a three-year period since we had just entered into a new three-year supply contract with the customer.

Instead of typical freight rate increases of 2–4-percent, as has been the norm over the past few renewals, the rates in this contract were increased 30–54-percent. Worse yet, we were initially presented with a *six-month* contract term instead of the usual and customary renewable one-year period. This strikes us as an unfair, predatory tactic.

After lengthy discussions with our account representative, a revised quote on a one-year basis was conveyed with an optional 2nd and 3rd year extension (with increases). The rates themselves were not reduced and in fact, one of the original rate offers was increased further, driving the total increase to 60-percent. Because of the rate increases, we were placed at an unfair advantage to our competitors. We were forced to take the exorbitant increases or cease doing business and at a risk of shutting down our production site and laying off employees in the process.

We do not favor "re-regulation" of the railroads. We are simply asking that the pro-competitive provisions passed into law as part of the 1980 Staggers Rail Act be implemented by the STB in a way that encourages competition among railroads. We believe free market forces are the best way to ensure that the rail transportation market works best for everybody. As with our Sulfuric Acid business, we advocate a competitive marketplace that will lead to greater efficiencies, innovation, better service and lower prices.

Again, we believe congressional action must be taken, and we ask you to ensure these matters are addressed in appropriate legislation as soon as possible. We look forward to working with you and your colleagues on the Committee.

Sincerely,

JACK FRANCIS,
Global Distribution Manager,
Akzo Nobel Chemicals Inc.

ATOFINA PETROCHEMICALS, INC.
July 24, 2002

Hon. JOHN B. BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear SENATOR BREAUX:

First let me thank you for giving us the forum to voice our concerns about rail transportation and the issues of competition and service.

I am representing ATOFINA, one of the largest chemicals companies in the United States. We have some forty manufacturing sites in the US and we make a variety of important chemicals.

Some of our businesses are completely dependant on rail to ship our products. The combination of our rail dependency and the trend of rail companies consolidating, has created a situation that can only be labeled for what it is . . .a monopoly.

With one rail company servicing two of our three plants, we are held captive to the pricing of that one rail company. We have limited negotiating power and leverage, and thus basically have no say in what we are charged.

The price differential between shipping from a facility serviced by a single rail company with one that has competition is staggering. Our own experience shows there to be 30–60-percent differences in rail freight costs for captive facilities versus facilities with competitive rail service. This is why ATOFINA is currently involved in projects that attempt to bring competitive rail service to our Bayport, Texas facility and our Carville, Louisiana facility. Without competition there is no negotiation. The railroad increases its price and we pay it.

Senator Breaux, we run top-notch manufacturing sites. We employ a lot of good people. And we produce useful products. We have tightened our belts in every aspect of running our business, and this is the one area where we have limited choices, limited options. We need your help.

We are asking for your support in encouraging rail competition. We need Congressional action to enhance competition in rail service. We also ask you to encourage the STB to give full and literal application to the existing statutory provisions from the perspective of promoting rail-to-rail competition, and also to give full, fair and expeditious consideration to the pending requests before the agency relating to both the Bayport and Carville projects.

Thank you for this opportunity, I look forward to hearing the results of your hearing.

Sincerely,

STEVE CORNELL,
VP Base Chemicals and Manufacturing,
ATOFINA Petrochemicals.

BASF CORPORATION
July 23, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

I am pleased to learn that you will be chairing a Senate Commerce Committee meeting on rail competition on July 31, and I am writing to urge your support for helping to make the U.S. freight rail system more competitive for all users. BASF Corporation is very concerned about the current lack of rail competition that exists. A competitive rail transportation system is essential for BASF and the chemical industry to receive raw materials and deliver products, i.e., to conduct its business.

75-percent of BASF's U.S. sites are captive to using a single available railroad. Captive shippers pay 20-percent higher rates because of the lack of rail competition. These higher rates cost BASF an extra $8 million per year, which impacts our competitiveness.

My experience is that service declines when there is no competition between railroads. This often results in late pick-ups and deliveries. When our products are delayed because of the monopoly-like abuses, BASF loses sales and customers.

In many instances, transporting by truck is not a viable option. As service by these rail carriers declines, there is no recourse for us—the railroad provider knows we have nowhere else to turn to move our products.

This captive shipping scenario is the result of the many railroad industry mergers that have occurred over the past 25 years. In 1976, there were 63 major freight railroads operating in the U.S. Only seven are left today. The competition that once characterized the industry has been replaced with a system rampant with service delays and higher costs.

As you know, the Surface Transportation Board (STB) is responsible for reviewing proposed mergers and setting service standards in the freight railroad industry. While BASF and others in the chemical industry have been active participants to revise the STB's rail merger guidelines, these revised guidelines do not go far enough. BASF believes that federal legislative action is necessary to further clarify and ensure competition in the freight railroad industry.

BASF has 12,000 U.S. employees, including 1,300 employees residing in Louisiana. We thank you for holding these hearings and addressing needed changes to improve our freight rail transportation system in this country.

Sincerely,

OTIS HALL,
Vice President and General Manager,
BASF Corporation.

BP AMERICA INC.
Naperville, IL, July 29, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,

Washington, DC.

Dear Mr. Chairman:

Thank you for holding the July 31st hearing to address the competition and service concerns of rail shippers. This is an important opportunity to address long-standing and growing problems faced by shippers who receive their service from only one railroad. Rail industry consolidation has decreased competition and diminished service for captive rail shippers. Unfortunately, the Surface Transportation Board (STB) has been unable to reasonably address these problems. BP, therefore, believes congressional action is necessary to increase the competitive transportation options for captive rail shippers and to ensure the adequacy of processes at the STB for protecting captive rail shippers.

BP is a leading petrochemical manufacturer in the United States with over 42,000 employees and sales of more than $6 billion from U.S. based chemicals businesses. Our company is highly dependent on the rail industry for the safe and timely delivery of over 4 million tons of product and raw material while spending $110 million in freight cost annually. A strong, healthy, and efficient freight rail industry is in everyone's best interest, and BP will gladly work with this Committee and Congress to ensure a robust rail industry. This cannot be accomplished, however, without effectively addressing the lack of competition for captive rail shippers.

BP can cite many examples of apparent overcharging by the railroads when a production facility or a customer delivery point is closed to competition. We have over 80-percent of our business captive at either origin or destination. An example of this impact is that one of our major businesses is significantly disadvantaged by lack of competitive access. Despite the efforts within the business to reduce manufacturing, site logistics, corporate overhead and other supply chain costs, we continue to be faced with high rail costs to competitively serve customers. In this business alone we pay an approximate premium of $9 million in rail freight annually, on a total spend of $35 million. This premium along with other competitive factors has caused BP to rationalize the business and shut down production sites and lines. Competition, much of which will be foreign in the future, requires us to have lower costs to compete. It is essential we have congressional support to allow us to be effective in meeting current and future competitive challenges.

BP does not favor "re-regulation" of the railroads. We are simply asking that the pro-competitive provisions passed into law as part of the 1980 Staggers Rail Act be implemented by the STB in a way that actually encourages competition among railroads. We believe free market forces are the best way to ensure that the rail transportation system works best for everyone. We are advocates of a competitive marketplace that will lead to greater efficiencies, innovation, and better service at reasonable rates.

Again, we believe congressional action must be taken, and we ask you to ensure these matters are addressed in appropriate legislation as soon as possible. We look forward to working with you and your colleagues on the Committee.

Please do not hesitate to contact Mr. Mike Brien of our Washington Office, (202) 785–4888, if you have additional questions or concerns.

Sincerely,

GEORGE TACQUARD,
Business Unit Leader, Nitriles.

CELANESE CHEMICALS
Dallas, TX, July 22, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

Celanese employs 5,400 Americans in high tech high wage earning jobs in the manufacture and distribution of chemicals, plastics and man made fibers. Our industry is highly dependent on rail to deliver raw materials and pick up finished products on a predictable and timely basis. A strong, healthy, and efficient freight rail industry is, therefore, in our best interest, and we will gladly work with this Committee and the Congress to ensure a robust rail industry. This cannot be accomplished, however, without Congress effectively addressing the lack of competition for captive rail shippers.

- Rail industry consolidation has decreased competition and diminished service for captive rail shippers. Unfortunately, the Surface Transportation Board (STB) has proven unable to adequately and reasonably address these problems. We, therefore, believe congressional action is necessary to increase the competitive transportation options for captive rail shippers and to ensure the processes at the STB for protecting captive rail shippers are workable.
- For Celanese, a freight premium of 30 to 40-percent is typically imposed at our plants without rail competition. This value gap is increasing, as railroads lower their prices in competitive markets and offset the revenue loss by increasing prices where they have no competition. Ultimately, this impacts decisions on where product is made, putting the economic viability of many existing plants and their communities at risk.
- Let me be clear: we do not favor "re-regulation" of the railroads. We are simply asking that the pro-competitive provisions passed into law as part of the 1980 Staggers Rail Act be implemented by the STB in a way that actually encourages competition among railroads. We believe free market forces are the best way to ensure that the rail transportation market works best for everybody. We are advocating a competitive marketplace that will lead to greater efficiencies, innovation, better service and lower prices.

Thank you for addressing the long-standing and growing problems faced by shippers who are captive to a single railroad for their distribution needs. We urge that these matters be addressed in appropriate legislation as soon as possible. We look forward to working with your Committee.

Sincerely,

LYNDON E. COLE,
President.

CHEVRON PHILLIPS CHEMICAL COMPANY LP
Houston, TX, July 23, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

Chevron Phillips Chemical Company LP (CPChem), a competitor in the global plastics and petrochemicals/chemicals industry, wishes to thank you for holding hearings to address rail competition and service concerns of U.S. rail shippers. This is a timely opportunity to address important issues facing companies that rely upon our country's rail industry.

While rail industry consolidations are beginning to deliver on their promises of improved rail service in many areas of the country, those same consolidations have almost eliminated any significant rail-to-rail competition in both the eastern and western U.S. Congressional action is needed to increase the competitive rail-to-rail transportation options for captive rail shippers (origins) and captive rail receivers (destinations).

CPChem has several rail "captive" manufacturing facilities and approximately 1/3 of our rail shipments are destined to "captive" customer locations. While we are not in favor of "re-regulation" of the railroads, we do think U.S. industry would be better served if the pro-competitive provisions passed into law as part of the 1980 Staggers Rail Act were implemented by the Surface Transportation Board (STB) in a way that actually encourages competition among railroads.

Free market forces are the best way to ensure that rail transportation services work best for everybody. We are advocating a competitive marketplace that will lead to greater efficiencies, innovation, better service and lower prices. We believe Congressional action must be taken, and we ask that you ensure these matters are addressed in appropriate legislation as soon as possible. We look forward to working with you and your colleagues on the Committee.

Sincerely,

JAMES L. GALLOGLY,
President and Chief Executive Officer

DOW CHEMICAL COMPANY
Midland, MI, July 30, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

Thank you for holding a hearing to address the competition and service concerns of rail shippers. This is an important opportunity to address the long-standing and growing problems faced by shippers who receive their service from only one railroad.

The chemical industry ships 143 million tons by rail each year and pays $5 billion in rail freight costs. 63-percent of all chemical facilities are captive to a single railroad. Surely, this is not what Congress had in mind when they passed the Staggers Rail Act. The number of major Class I railroads in the U.S. has declined from approximately 42 to only four. These four railroads, which control 88-percent of originated chemical shipments, do not even really compete with each other because they serve different geographies. This consolidation has dramatically decreased competition, diminished service and increased costs. Unfortunately, the Surface Transportation Board (STB) hasn't adequately or reasonably addressed these problems.

We depend on rail transportation for the cost-effective, efficient movement of our raw materials and products. With transportation being the second highest cost factor in chemical production, second only to feedstocks, one easily can see how the quality and cost of rail transportation directly affects our ability to compete in a global marketplace. Dow, as the world's largest chemical and plastics producer, is experiencing first-hand that captive shippers are paying the highest rates and receiving the poorest service. Dow is captive to the same railroad at its four largest U.S. plant facilities. It is well understood that being captive at a facility normally means rail freight costs about 30-percent higher than facilities served by two railroads.

A strong and efficient freight rail industry is in everyone's best interest, and we will work with Congress to ensure a robust rail industry. This cannot be accomplished, however, without effectively addressing the lack of competition within the rail industry. We are not in favor of re-regulating the railroads, but rather ask that the pro-competitive provisions passed into law as part of the Staggers Rail Act be implemented by the STB in a way that actually encourages competition among railroads. Again, we ask you to ensure that these matters are addressed in appropriate legislation as soon as possible.

Kindest regards,

MICHAEL D. PARKER,
President and CEO

DUPONT
July 30, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

Re: Senate Hearings on Rail Competitiveness

E.I. DuPont de Nemours and Company (DuPont) would like to express its appreciation to you and your staff for agreeing to hold hearings on the current state of competition and service concerns affecting the freight rail industry.

DuPont, a U.S. corporation, headquartered in Wilmington, Delaware, is a global science and technology company engaged in the manufacture, sale and distribution of chemicals, crop protection products, paints, textiles, resins, plastics and related materials. Much of the raw material and finished products produced and/or utilized by DuPont's (insert number) U.S. manufacturing facilities are shipped by rail. In addition, as one of the largest exporter of U.S. manufactured chemicals and related products (according to Journal of Commerce figures, DuPont is currently the third largest U.S. exporter), DuPont is highly dependent upon the domestic rail system to service its global marketplace.

The events of September 11, 2001, traditional safety concerns and fundamental economics surrounding the transportation of hazardous materials and bulk products have served to increase DuPont's already heavy dependence on freight rail transportation. A strong, healthy and efficient freight rail industry is essential to DuPont's ability to compete both within the United States and abroad.

DuPont, however, is very concerned about the lack of effective competition within the rail industry. In 1980, when the Stagger's Rail Act was passed, Congress expressed it's concern about the then deplorable financial position present in the rail industry. The Stagger's Act recognized this condition and attempted to reduce expensive and counterproductive regulation in order to permit the industry to rebuild and recover its financial health.

In the years since the passage of the Stagger's Act, the rail industry has been substantially restructured and has dramatically improved its overall financial position. However, during this process in kind competition between rail carriers has been greatly reduced. The competitive market place forces which Congress had correctly relied upon to "regulate" the industry have all but disappeared. This has resulted in a substantial increase in the number of "captive shippers", reduction in service (and security) options, a less responsive and innovative rail partner and the imposition of a "monopoly premium" in excess of 30-percent being imposed upon captive shippers

The time, therefore, has come to re-examine the Stagger's Act and its underlying premise. New mechanisms must be imposed and used to restore in kind competition among in kind rail carriers where such competition does not currently exist. DuPont believes that such competition in the rail industry will result in improved overall freight rail service and will serve to aid, the aid the rail industry in recapturing much of the freight and bulk transport business lost to motor carriers since the conclusion of WWII. The recapture of this business will increase the financial strength of the rail industry and result in a "win-win" solution for both the rail industry and its customers.

DuPont does not believe in regulation (or re-regulation) where market forces can be effective. However, if competitive market forces are absent, some workable substitution must be discovered and applied if our economy is to maximize its potential. DuPont is most willing to work with the railroads, the Surface Transportation Board and Congress to find a viable and mutually beneficial solution to our current problems. We welcome your interest and look forward to meeting with you and your staff to begin this worthwhile effort.

Respectfully submitted,

GERARD J. DONNELLY,
Global Director, Logistics,
DuPont.

LYONDELL CHEMICAL COMPANY
Houston, TX, July 24, 2002

Hon. JOHN BREAUX,
Chairman
Senate Subcommittee on Surface Transportation and Merchant Marine, Subcommittee,
Committee on Commerce, Science, and Transportation,
Washington, DC

Dear Chairman Breaux:

I am writing to offer comments from Lyondell Chemical Company as the Senate considers captive rail issues at its July 31st Subcommittee hearing.

Lyondell is a leading chemical manufacturer with 10 plants in the U.S., including one with 370 jobs in Lake Charles, LA. As the nation's leading export industry, the chemical business is a major contributor to our country's success. It produces the critical building blocks for products that make our lives safer, healthier and more convenient. Automobiles, housing, clothing, food packaging and consumer goods of all kinds are made better through the use of products manufactured by the chemical industry.

The continued commoditization of the chemical industry is making us more and more dependent on an efficient logistics process to serve our global customers. Approximately 85-percent of chemical industry products are delivered in bulk via rail transportation.

Almost two out of every three chemical plants in the U.S. are held captive by one railroad. When this non-competitive situation exists we find ourselves at a severe economic disadvantage, in that freight rates are up to 60-percent higher than in a situation where there are competitive options. The consequences of these higher costs and poorer service are eventually borne by the consumer.

Fortunately, multiple rail carriers serve Lyondell's plant at Lake Charles. However, at Bayport, Texas, a lack of competitive rail access has driven Lyondell, Equistar Chemicals, ATOFINA Petrochemicals, Basell USA and the BNSF Railroad to initiate a rail infrastructure "build-out" project. This $90 million, twelve-mile project, currently under review by the Surface Transportation Board, is necessary for us to get relief from a captive market situation and to obtain shipping rates that will allow us to cost-effectively supply our sites in the Bayport industrial district.

As a chemical company we strongly prefer to invest in what we know best—the business of chemistry. However, when "held hostage" we, as captive shippers, have demonstrated that we can take decisive action to protect our business. Unfortunately, investing in these types of mandated rail projects comes at a high price. Since these projects deprive our core business its desired funding level, we increase the chance that our business growth objectives will fall short, reducing the benefit to company shareholders, employees, and the community at-large.

Thank you for holding this hearing so that we had the opportunity to comment to Congress about the serious need for better railroad access and for more railroad competition. We hope you remember and address the many shipper issues you will hear about on the 31st as Congress looks to reauthorize the Surface Transportation Board next year.

Sincerely,

DAN F. SMITH,
President and CEO.

OXYCHEM
Dallas, TX, July 29, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

Thank you for holding the July 31, 2002 hearing to address the competition and service concerns of rail shippers. This is an important opportunity to address long-standing and growing problems faced by shippers, and particularly chemical shippers, who receive their service from only one railroad at a shipping location.

The negative effect of being captive to a single railroad, or conversely the lack of rail competition, has grown over the years. If you roll back the clock to the late 1970's, we had over sixty Class I railroads in the United States. Now we're down to four major Class I railroads; two in the east and two in the west. Although the Staggers Act passed into law in 1980 had the foresight to give the regulating entity, the Interstate Commerce Commission and now its successor, the Surface Transportation Board (STB), the ability to create and enhance competition, the STB has proved unable to adequately and reasonably address the problem. For example, the chemical industry provides approximately 9-percent of the nation's rail volume and approximately 13-percent of the rail revenue; a disproportionate relationship.

The chemical industry is highly dependent upon the railroads to deliver both our outbound products and inbound raw materials. We believe a strong, healthy and efficient rail industry is not only in our interest, but also in the best interest of the overall economy and we are willing to work with this Committee and the Congress to ensure this happens. However, this cannot be accomplished without effectively addressing the lack of competition for the approximate two-thirds of the chemical industry that is captive to one railroad at any one location.

Let me give you a specific example of how damaging the lack of rail competition can be. We ship large quantities of an intermediate material used in the process of producing PVC, by rail in company owned tankcars. We ship this product from our US Gulf plants to several locations. There are two receiving locations, one with two serving railroads and one with one serving railroad. Both destinations are approximately equal distance from the shipping locations. However, the freight rate to the location with one serving railroad is 60 to 76-percent (depending upon actual origin) per mile higher than the freight rate to the location with two serving railroads.

In fact, it would be much cheaper for us to ship to the location with two serving railroads and reship by rail from that site to the location with one serving railroad. However, the captive railroad won't provide a reasonable rate for that short movement (referred to as a bottleneck), so we're forced to pay this exorbitant premium.

What we are asking for has sometimes been characterized by the railroads as "re-regulation". This is not what we seek. We are simply asking that the pro-competitive provisions passed into law in 1980 with the Staggers Act be implemented by the STB that actually encourages competition among railroads. Just as we operate everyday in the free, open and competitive market system, the railroads need also to ensure the best for everybody. Time and time again, we've seen that a competitive marketplace leads to greater efficiencies, innovation, better service and better value for dollars spent.

We believe the only answer to the rail competitive issue is congressional action. We ask you to ensure these matters are addressed in appropriate legislation as soon as possible. We look forward to working with you and your colleagues on the Committee on this very important subject.

Respectfully submitted,

JOHN L. HURST, III,
Executive Vice President

SUNOCO, INC.
Philadelphia, PA, July 29, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

Thank you for holding today's hearing to address the competition and service concerns of rail shippers. This is an important opportunity to address long-standing and growing problems faced by shippers who receive their service from only one railroad.

Rail industry consolidation has reduced competition and limited service options for captive rail shippers. Unfortunately, the Surface Transportation Board (STB) has proven unable to adequately and reasonably address these problems. We, therefore, believe congressional action is necessary to increase the competitive transportation options for captive rail shippers and to ensure the processes at the STB for protecting captive rail shippers are workable.

The chemical industry is highly dependent on rail to receive raw materials and deliver finished products on a predictable and timely basis. A strong, healthy, and efficient freight rail industry is, therefore, in our best interest, and we will gladly work with this Committee and the Congress to ensure a viable rail industry. This cannot be accomplished, however, without effectively addressing the lack of competition for captive rail shippers.

Sunoco ships and receives in excess of 38,000 rail carloads annually and we require safe, reliable and consistent service to supply our plants and customers. One rail service example illustrates why competition is critical to our rail operations. The rail carriers are willing to offer service accountability on select competitive movements; yet are unwilling to stand behind their service product on lanes where no competition exists. Our ability to deliver products competitively from two of our single railroad served plants is hindered by the local carrier being inflexible on economic demands; often necessitating supplying a customer from a much more distant competitively served site producing the same products.

We do not favor "re-regulation" of the railroads. We are simply asking that the pro-competitive provisions passed into law as part of the 1980 Staggers Rail Act are implemented by the STB in a way that actually encourages competition among railroads. We believe free market forces are the best way to ensure that the rail transportation market works best for everybody. We are advocating a competitive marketplace that will lead to greater efficiencies, innovation, better service and lower prices.

Again, we believe congressional action must be taken, and we ask you to ensure these matters are addressed in appropriate legislation as soon as possible. We look forward to working with you and your colleagues on the Committee.

Sincerely,

BRUCE FISCHER,
Senior Vice President.

Senator ROCKEFELLER. Thank you, Mr. Platz, very much, and I now call upon Mr. Terry Huval—did I get that right?

Mr. HUVAL. That is correct.

Senator ROCKEFELLER. From the Lafayette Utilities System, Lafayette, from some State called Louisiana.

[Laughter.]

STATEMENT OF TERRY HUVAL, DIRECTOR, LAFAYETTE UTILITIES SYSTEM

Mr. HUVAL. Oui, Monsieur. Bonjour.

Thank you very much for the invitation, and for the opportunity, and I certainly am impressed with the intense interest that both of you, Senators, are showing to this very important issue. I would like to also comment that I have my 10-year-old son, Andre, who is here with me today to see good Government in action.

I want to tell you a little bit about the Lafayette Utilities System. We are a publicly owned utility system. I have submitted some written comments also for the record.

I am also representing the American Public Power Association, of which I am on the board of directors, and I also represent Consumers United for Rail Equity, or CURE. There are also hearing record statements on captive rail issues being offered by AEP, Southwestern Electric Power Company, Entergy Services, Incorporated, the Association of Louisiana Electric Coops, and the Louisiana Energy and Power Authority, LEPA, of which I am also on the board of directors.

I find this an interesting issue that most of the time the investor-owned utilities and the coops and the municipalities have different ways of looking at things. This is one issue that we are all together on.

LUS is a provider of electric, water, and wastewater services in Lafayette. We are the largest in the State of Louisiana as a public power entity. We are consumer-owned, locally committed. Every dollar we save goes back to the customer, either by virtue of the rates going down, or finding ways to help pay for the cost of local government. Our cost has historically been low, and our reliability has been high.

Two-thirds of our electric generation comes from coal-fired capacity, of which we are co-owner. LEPA is another co-owner of that particular facility, and in that particular facility we have coal shipped from the Wyoming Powder River Basin to our plant, and I guess this is a good time to discuss our rail captivity problem.

We are a bottleneck shipper, and this map behind me will indicate three colors of lines from Wyoming to Louisiana. One is red, one is green, and one is blue. The red is our existing provider of services, the green and the blue are two alternative carriers that we could have service us, or at least go to a particular location not very far from us.

The last 19 miles of this 1,500-mile distance from Wyoming to our plant, the last 19 miles are obviously owned by one rail company. There is no competition there, so because of that 1.3 percent of the total route being a monopoly, the entire route is a monopoly. We have no opportunity—reasonable opportunity—we feel, to get competitive pricing, to build on the section that we could get competitive pricing, and in order to receive competitive pricing from another provider, we would have to have the cooperation of the existing provider, which of course, left to their own devices, has really no incentive to join in any type of cooperative effort that provides for competition, and as I said, therefore the entire route is a monopoly.

As a result, our customers are paying more for electricity. I cannot discuss, because of the confidentiality of the rail contract, the specifics, but our experts tell us that we are spending about 50 percent more for rail transportation than we should be, with coal transportation being one of our single largest cost items. That amounts to about $5 or $6 million a year for our customers. That means the businesses, that means the homeowner, that means the mom and pops out there. They are paying more money for electricity because we do not have a choice in the transportation of our coal to our plant, and of course it creates an economic development issue also in trying to come up with competitive pricing to attract new development into the community.

We have three limited options. One is to seek bottleneck relief, one is to pursue build-out relief, and the third is to have an origin-to-destination rate case filed. On bottleneck relief, as you discussed earlier, we have to get a competitive price before we can request a rate case for the bottleneck relief.

Well, you cannot get a competitive price from the competitor. We have tried, and they have basically said, for you to get a competitive price from us, you have to build alternative facilities to attach to us, or have the ability to attach to us, which we cannot make happen, so it is kind of the chicken or the egg sort of scenario, and we cannot make that work.

What you find in the industry, as I understand it, is a lack of poaching of each other's customers. I will not go on your turf and try and take your customers if you do not go on my turf and try to take my customers, so either the interpretation from the Surface Transportation Board needs to change, or either Congress needs to change the law, or otherwise we really have no option.

The second option we have is build-out relief, and some utilities have built facilities to get competition, and generally from an operational perspective that can be worked out, if the rail companies want to work it out.

We have investigated rail facility construction, but it just seems absurd to me that public policy is such that we have to spend tens of millions of dollars to build alternative rail facilities to our location when it is an issue of just that last 19 miles, and I will submit to you, I have learned since I submitted my testimony that there are some companies that actually have gone ahead and made the $40 and $50-million investments to get a second rail provider only to have that second rail sit essentially dormant because the initial rail provider came down on the price, so it is infrastructure being installed that is unnecessary in the long term.

The origin-to-destination rate case relief, something that has been discussed earlier, is very prohibitive, especially for a small company, up to $61,000 filing fee, the shippers taking most of the burden of proof, taking over 2 years to complete and litigation costs in the millions of dollars. The difficulty that the Surface Transportation Board has had in hearing rate cases as far as the length of time associated with it, there has to be a simpler way to be able to get easier and less expensive rail transportation for us.

And now I will come to my conclusion, how you and Congress can help us. We need reasonable access to competition. Specifically, we need to have shippers provide us pricing with a competitive option, such as the distance between Alexandria in Louisiana and Wyoming, and to have a fair, regulatory process that determines the pricing for the last 19 miles.

We need to reduce rate case filing fees to perhaps no more than what is applicable in the Federal District Court. We need to reallocate some of the burdens in rate cases to the railroads and provide the Surface Transportation Board with sufficient resources.

And the bottom line is, this country in the last 20 years has moved to a number of deregulation types of environments, some of them with varying successes, and certainly we support deregulation, but there needs to be in that environment an opportunity for those who are captive, those who have no choice to be able to get fair treatment.

I thank you for your attention.

[The prepared statement of Mr. Huval follows:]

PREPARED STATEMENT OF TERRY HUVAL, DIRECTOR, LAFAYETTE UTILITIES SYSTEM

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity and the invitation to appear before you today to discuss captive rail shipper concerns.

My name is Terry Huval and I am the Director of the Lafayette Utilities System in Lafayette, Louisiana. I am appearing today on behalf of Lafayette Utilities System and both the American Public Power Association (APPA) and Consumers United for Rail Equity (C.U.R.E.), of which we are members. In addition, Mr. Chairman, I am pleased to offer for the hearing record statements on the captive shipper issue from other utilities that provide power to Louisiana consumers: AEP Southwestern Electric Power Company, Inc., Entergy Services, Inc., and the Louisiana Energy and Power Authority (LEPA).

In order to make the best use of our time, I have divided my statement into four sections: (1.) a brief introduction about the Lafayette Utilities System; (2.) a discussion about the coal-fired Rodemacher Power Station from which LUS receives much of its electrical generation; (3.) a synopsis of our rail captivity problems; and (4.) a summary of what we are asking Congress to do to help us.

1. Introduction

First, a few statements about Lafayette Utilities System, or LUS. LUS was established in 1896 and provides electric, water, and wastewater services to the citizens of Lafayette, Louisiana. Today we provide electricity to households and businesses in a community of over 110,000 people. As a customer-owned and operated utility, subject to the jurisdiction of our City Council and, ultimately, the people, we establish our rates, control our standards of service and, of course, retain all of the proceeds of our sales to provide substantial financial support to the remainder of our local government functions. LUS is committed to providing electricity to our customers at the lowest possible cost and the highest reliability of service.

2. Our Coal-Fired Generating Facilities

The LUS system generates approximately 588.5 Megawatts of electricity, 327 Megawatts through three gas fired units and 261.5 Megawatts through its 50 percent ownership share of the coal-fired Rodemacher Power Station Unit No. 2 located in Boyce, Louisiana.

Rodemacher Unit No. 2 is a 523 Megawatt unit that also provides 104.5 Megawatts of power to the Louisiana Energy and Power Authority ("LEPA"). LEPA is a joint action agency that collectively represents 18 Louisiana municipalities that also own and operate their own electric distribution systems. The third co-owner of the remainder of the plant's capacity is responsible for plant operations and for obtaining coal transportation.

The Rodemacher co-owners collectively purchase coal from mines in the Wyoming Powder River Basin. The only practical way to transport this coal from Wyoming to Rodemacher (a distance of over 1500 miles) is by rail. To facilitate our rail deliveries, the Rodemacher co-owners have obtained, at their own expense, four trainsets of coal cars (over 500 cars).

3. Our Rail Captivity Problem

Now, Mr. Chairman, let me share with you our experience in a non-competitive rail situation.

A. LUS is a Bottleneck Captive Shipper

I have appended a schematic to my testimony to help illustrate our situation. Two different railroad companies serve our Powder River Basin mine origin. Thus, we enjoy a choice of railroads at our coal origin. Alternative rail providers can transport our Powder River Basin coal deliveries to Alexandria, a distance of approximately 1506 miles. (The Official Railroad Station List shows railroad interchange traffic between our existing rail provider and an alternative rail provider in Alexandria, Shreveport, and other points in Louisiana. Alexandria is the nearest listed interchange point to Rodemacher). So, as you can see, there are competitive options for rail transportation for the entire length of the movement to Alexandria.

Beyond that point, our current rail provider owns the only rail line between Alexandria and Rodemacher—a distance of approximately 19 miles. As a consequence, the Rodemacher owners are "captive" to our current provider since it is the only rail carrier serving this plant. Under current law, the current rail provider's control of the last 19 miles allows it to push its pricing monopoly all the way back to the Powder River Basin—turning a 19 mile monopoly into a 1500+ mile monopoly. Left to its own devices, our current rail provider will simply quote rates only from the Powder River Basin-to-Rodemacher. It has no incentive to join in any other co-operative bids with alternative rail carriers that would provide LUS the benefits of competition. Naturally, the current rail provider has no interest in competing against itself and will keep the Powder River Basin-to-Rodemacher business to itself. Thus, the Rodemacher owners face a transportation monopoly from its existing rail provider.

B. Our Customers are Paying Higher Electricity Rates Because of our Railroad Captivity

Due to this monopoly, LUS pays substantially higher coal transportation prices than other western coal transportation customers that enjoy effective origin-to-destination rail competition. In common with most rail contracts, the Rodemacher co-owner's current transportation contract with its rail carrier precludes us from disclosing our actual transportation prices, or getting into the details concerning our freight rate levels. However, publicly available information suggests our current transportation prices are at least 50-percent higher, on a mileage adjusted basis, than rates where there is rail-to-rail competition for long-haul western coal train deliveries.

For the Rodemacher owners, and their customers, this lack of competition translates into millions of dollars per year in "captivity payments"—the difference between what we pay our existing rail carrier compared to what we would pay if we enjoyed railroad competition. Specifically, for the case of Lafayette, Louisiana, the annual cost of these captivity payments is about $5 to $6 million. These higher payments are included in LUS' customers monthly electric bills and cause higher utility bills both for individuals and for the businesses in Lafayette. Please note in this regard, that the cost of coal transportation is one of the single largest cost items included in our electric generation costs.

C. Our Limited Options

What can we do to obtain transportation competition? Our options under current law are limited.

- *Bottleneck Relief.* One option would be to ask the alternative rail providers to contract with us for a competitive market price for service between the Powder River Basin and Alexandria. Under the Surface Transportation Board's 1996 "*Bottleneck Decision,*" if LUS were to secure such a contract, our existing provider would be required to provide us with a reasonable price to transport this alternatively transported coal traffic the 19 miles from Alexandria to Rodemacher.

However, our experience has shown that getting a bid from a competitive provider under such a scenario does not occur. As we understand it, the large western rail carriers generally refuse to provide such bids. Their collective concern appears to us to be if Carrier A "poaches" Carrier B's captive customers by providing such contracts, Carrier B will then retaliate by "poaching" Carrier A's captive shippers. So unless either the Surface Transportation Board changes its interpretation of the law, or Congress changes the law to require railroads to quote "bottleneck rates," this option simply is not available.

- *Build-Out Relief.* A second option is to look at rail construction. Several utilities in the west and south have broken their captivity to a single rail-delivery carrier by constructing new access lines to obtain service from a second rail carrier. With second carrier access, these shippers usually report that they can obtain origin-to-destination competitive rail service and competitive rail prices.

In general, these "build-outs" are usually quite expensive, when they can be accomplished at all, and they result in the unnecessary duplication of existing rail facilities. I have been told that in most instances, there are no significant operating, or other, problems that would preclude a second carrier from using the incumbent carrier's existing rail line to serve a captive utility plant. However, the law generally does not require monopoly destination rail carriers to allow competitive carriers to use their track—even for short distances like the 19 mile line owned by our existing carrier which would be needed by an alternative carrier to serve the Rodemacher plant.

In the past, LUS and its Rodemacher co-owners have explored constructing facilities that would allow direct alternative rail providers access to Rodemacher. In our case, any such access would most likely entail construction of a rail bridge or conveyor system across the Red River and Interstate 49. It seems absurd that current federal transportation policy is such that small municipal entities like LUS must even study such projects when other alternatives make much more sense, for example, requiring our existing carrier to transport our coal from Alexandria to Rodemacher at a fair price. With such a legal requirement, there would be no need for us to consider construction of costly, duplicative second carrier access facilities at a cost which would be passed on to our electric customers.

- *Origin-to-Destination Rate Case Relief.* A third option is really no option at all, and that is to obtain origin-to-destination common carrier rates from our existing rail provider to apply after our transportation contract expires. Obtaining these rates would allow us to initiate a maximum rate complaint with the Surface Transportation Board. Such a complaint could result in a maximum rate prescription order from the Surface Transportation Board for our Powder River Basin-to-Rodemacher transportation. This option cannot, however, produce competitive pricing under current law.

By law, the Surface Transportation Board cannot set maximum rates at less than 180 percent of a railroad's variable costs (including capital costs). However, I am advised that in competitive coal transportation markets, the transportation rates should be substantially less than 180 percent of the railroads' costs (while still ensuring the railroads earn a healthy profit margin). As a result, the Surface Transportation Board relief simply cannot give us competitive market rate for the competitive segment of our rail transportation (Powder River Basin-to-Alexandria).

I would also add that the Surface Transportation Board maximum rate process is most difficult for smaller entities like LUS. We understand that just to initiate a rate case requires the shipper to pay a filing fee of $61,400, that the shipper carries most burdens of proof, that the time required to complete such an effort would be a minimum of 2 years and that the expected litigation costs would be in the millions of dollars.

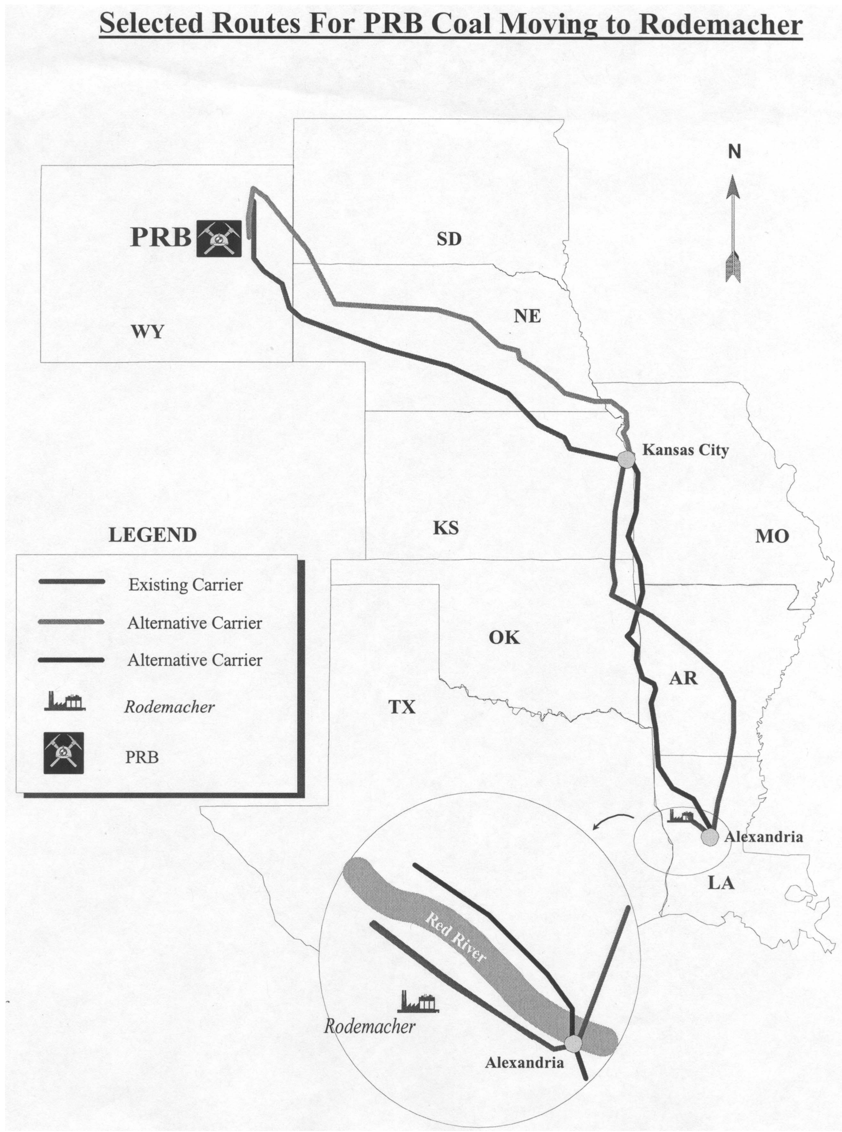
Finally, Mr. Chairman, it has been pointed out to me that the February, 1999 GAO Report entitled "Current Issues Associated With the Rate Relief Process" found that the Surface Transportation Board only has the resources to process two rate cases at a time. Twelve rate cases are currently pending at the Surface Transportation Board. Smaller entities like LUS need a simpler, easier, and less expensive process that produces fair results.

4. How Congress Can Help

Mr. Chairman, let me describe how we believe Congress can help us. What we want the most is reasonable access to rail competition. If the Surface Transportation Board or the Congress would change the current decision regarding “bottlenecks” and require our existing rail carrier to provide reasonable rate and service terms from Alexandria-to-Rodemacher, we would at least have competition from the Powder River Basin to Alexandria. This competition could result in reduced rates for the entire movement of our coal from the Powder River Basin to Rodemacher. We would also like to see Congress reduce the filing fee for rate cases to no more than the filing fee that is applicable in Federal district courts, reallocate some of the burdens of proof in rate cases to the railroads and provide the Surface Transportation Board with sufficient resources to process their rate cases in an efficient manner.

Also, over the past two decades Congress has passed legislation de-regulating a number of industries. In doing so, Congress has usually required non-discriminatory, and open access to existing infrastructure. It would appear to be consistent for similar legislation to apply to the rail industry.

Mr. Chairman, in conclusion, we thank you for providing us the opportunity to appear before you today and we appreciate your interest in these important issues.



Senator ROCKEFELLER. Thank you, Mr. Huval.

John Snow, you are not going to believe this, but we are not doing what we are about to do deliberately. We have about 4 minutes left on the first of four votes. That will take an additional hour. John Breaux is on his way back, because he has voted, had to give a final speech and has voted, will be back, and will hear your testimony. Byron and I probably will not, and it is not planned that way, all right. I want you to understand that. It is just the way the thing worked out, and as John said at the beginning, he wanted you to be the last person. The vote situation did not work out, so I apologize to you.

We will be in recess just briefly until John comes back. We will have questions to submit in writing. We hope that you will respond, and again apologize.

Senator Dorgan.

Senator DORGAN. Mr. Chairman, let me just make the point, the votes that are occurring will last perhaps up to another hour. I expect we are probably going to have to submit questions in writing to all of the witnesses. I regret that, but Senator Breaux went, as Senator Rockefeller said, to get the front end of this first vote so he can come back and take your testimony, Mr. Snow.

Let me also say that while these things happen here in terms of scheduling, this is a very important issue, and we deeply appreciate the testimony that has been given. This is not some idle issue for debate. This affects people in a very significant way, and Congress needs to sink its teeth into this and come up with some solutions, so I appreciate all of you being here today. Mr. Snow, I will digest your testimony, I guarantee you, and I appreciate your being here as well to testify on behalf of the railroads.

We will take a 5-minute recess. Senator Breaux should be here momentarily, at which point he will take the final testimony.

Mr. SNOW. Thank you very much.

Senator ROCKEFELLER. Thank you.

[Recess.]

Senator BREAUX. The Committee will please come to order. If our guests could please take their seats. You have heard the expression, this is no way to run a railroad. This is probably no way to run a Committee, but unfortunately the Senate has a number of votes, and we were unavoidably interrupted, and will be again, but I understand from my colleagues that Mr. Snow, you are the witness that still needs to make his statement, and we will be delighted to hear from you.

STATEMENT OF JOHN W. SNOW, CHAIRMAN AND CEO, CSX CORPORATION

Mr. SNOW. Thank you, Mr. Chairman, and with your permission, I will begin with a brief update for you and the Committee on the recent Amtrak derailment.

Senator BREAUX. That will be helpful. We talked about that.

Mr. SNOW. It is a very unfortunate incident. There is really nothing more painful about being in the railroad business than to experience a derailment. This was a derailment of an Amtrak train headed to Washington from Chicago carrying about 200 people, that derailed a little before 2:00 in the afternoon in Kensington, Maryland, just 10 or 11 miles from its ultimate destination.

There were about 200 people on the train, and approximately 90 were injured. Fortunately, only a handful, six, I think, were seriously injured, and there do not appear to be any life-threatening injuries.

I certainly want to express my appreciation and thanks to the good people of Montgomery County, the fire, the police, the medical personnel and, the rescue teams, as well as those in the D.C. Metropolitan Area generally, who came to the aid of the accident victims. It really was a terrific performance on the part of so many, and they acted with great professionalism, and undoubtedly made a terrible situation much better than it otherwise would have been, so my hat is off to them.

We are working closely, Mr. Chairman, with the NTSB, the FRA, and Amtrak, to investigate the incident. Because the incident is the subject of an ongoing NTSB investigation, it would not be appropriate for me to speculate on the cause. However, because of the impact of the extreme heat—the track was at a temperature of 118 degrees—we immediately took proactive actions across the railroad to reduce the speed of all passenger trains to the speed of most of our freight trains. This should be helpful in these incidents.

These are rare incidents, I must say. We have not had a passenger train incident in the prior decade that I am aware of that involved one of these so-called sun kinks, but we are taking precautions. We are looking at maintenance practices, and we are giving the matter every bit of our attention, working with the Federal authorities.

Senator BREAUX. May I just ask a question, Mr. Snow, on that? Who sets the speed of the trains on the tracks? Is that FRA's responsibility?

Mr. SNOW. The FRA sets speed limits, maximum speed limits for track quality, for track of certain grades. Amtrak track, track that can handle the intercity Amtrak trains on the Nation's freight rail system, as opposed to the Northeast Corridor, has a maximum speed of 79 miles an hour, and we, the freight railroad, will sometimes put in place slow orders where there are conditions that might require it, where track work is being done, where there is a concern about heat, or concern about freezing, and conditions that cause aberrations in the track.

Senator BREAUX. Is there any reason—I am struck by the fact that apparently we have one speed for freight railroads and one speed for our passenger Amtrak. Is there any logic—I thought, you know, the speed would be the same, whether it is a train carrying passengers, or whether it is a train carrying cargo. Why would we have one speed for freight, one speed for passengers?

Mr. SNOW. Well, because the passenger trains can safely run at higher speeds than the freight trains. We, for safety as well as just pure economic reasons, do not want to run the big coal trains that are carrying 12,000 tons of coal at 60 or 70 miles an hour. If we ran them at those speeds the effect of that weight on the track structure would require very heavy maintenance. So, we run those merchandise trains more in the 40, 45, 50 mph range and we run the heavy coal trains at much lower speeds, 35 or 40 mph.

Senator BREAUX. The Committee does not want to speculate, as you have said, on the cause of the accident, what needs to be done. Obviously, it is under investigation. We agree that the loss of lives did not occur, and that the response was really incredible, as far as what happened out there to take care of the passengers, and as they say, it could have been a lot worse, and thank goodness it was not, and we will follow it very, very closely.

So you heard the testimony of the shipping panel, and if you could use your time to try and respond.

Mr. SNOW. I can briefly respond. The basic point of the shipping panel, if I interpreted it properly, is that railroads are charging rates that are too high, and those rates are the product of lack of effective competition in many markets.

The railroad industry's response I think is very straightforward. The industry to sustain itself needs to engage in what is called differential pricing. We price to the traffic that is competitive through the marketplace, which sets those rates, and we try and secure from that competitive traffic the maximum we can. Some of that traffic makes only a small contribution over variable costs. Some makes a larger contribution over variable cost, but the traffic cannot provide a larger contribution than the contribution the market will permit and we are able to achieve.

Then we turn to the so-called captive traffic. That is traffic which for one reason or another has less, fewer alternatives, and the captive traffic then, if we are going to sustain the freight industry, needs to pay a higher price.

I think the Staggers Act was a very enlightened piece of legislation, and I take my hat off to you and your colleagues who were here in 1980, who brought that legislation about. That legislation was a response to the fact that large parts of the rail industry were in a state of utter decay, decline and deterioration, and if the forces of decay and decline and deterioration had been allowed to go on, we would not have had a private sector rail industry.

I happened to have been in the Federal Government when Penn Central went bankrupt, when the Milwaukee went bankrupt, when the Rock Island went bankrupt, and it fell to me to work on policies to try to deal with those issues. The policies we came up with were to create a less-regulated, more market-based rail industry. Fortunately, those policies were continued under the Carter administration, and in October 1980 the Staggers Act became law.

The heart of the Staggers Act was a recognition that the railroad industry operated in both competitive markets and in less-competitive markets. In the markets where it was competitive, competitive market forces should be allowed to set the rates. In markets that were not competitive, there was protection from price-gouging, excessive rates, through the Surface Transportation Board, then the Interstate Commerce Commission.

Also at the heart of the Staggers Act was the recognition that the rail industry, if we were to sustain a private sector rail industry in America, had to have the opportunity to earn adequate revenue levels. To earn adequate revenue levels, the railroad industry has to engage in differential pricing.

The gentlemen to my left and right, I think, take exception to the practice of differential pricing, but for the life of me I do not know how we can have on the one hand a successful private sector industry and on the other not have differential pricing, and that is the fundamental rub we have here. I think the STB tries to work its way through that balancing act in a fair and reasonable way. I must say, we seem to be losing more of those cases than we are winning lately, but I think the basic framework is sound.

Our dilemma, Mr. Chairman, is a very real one in the freight railroad industry. At current earning levels, we simply are not generating enough cash flow to replace the plant, and if we cannot replace the plant, then we are not going to be able to sustain the quality of service and level of service the shippers receive today.

I was struck, as I listened to the discussion, that if it had not been for the Staggers Act we could be having a very different discussion today. We could be having a discussion about how a nationalized freight rail industry is performing, and how the people that are running that nationalized freight rail system, the counterpart to Amtrak, are running service and setting rates.

I think we are much better with a market-based freight rail system with reasonable regulation, and I must say, having been around this for a long time, I do not think the debate will ever end on how high a rate is too high a rate, or what really constitutes a reasonable maximum rate, but I would trust to qualified professional people at the STB to get that question about as right as anybody can, recognizing we are going to lose as many cases as we win.

I thank you very much.

[The prepared statement of Mr. Snow follows:]

PREPARED STATEMENT OF JOHN W. SNOW, CHAIRMAN AND CEO, CSX CORPORATION

Introduction

Mr. Chairman and Members of the Subcommittee, it is a pleasure for me to be here today to discuss with you the progress of the railroad industry under Staggers and related issues with respect to our customers. Both the railroads and our customers have an important parallel interest: the sustainability and growth of our respective businesses. In order for the railroads to meet their objective of sustained growth, it is clear that we must secure adequate revenues that earn our cost of capital over the long run. This has been the unachieved goal of the Staggers Act from the railroads' perspective, one that is important not only to the rail industry but to the customers that it serves. Only a financially strong industry can ensure the kind of service that our customers need to capitalize on their growth opportunities.

The Rail Advantage

For 175 years, railroads have been an essential and enduring part of our nation's transportation infrastructure. The Baltimore and Ohio Railroad, the nation's first common carrier, was founded in 1827, and is part of the rich legacy of my company. The B&O and other pioneer railroads gave rise to the development of the fledgling nation, proved themselves in a variety of conditions that included wartime as well as peacetime, and have established a significant relevance in our modern era by our willingness to change, adapt and innovate.

Today, U.S. freight railroads—the major Class I's, regionals and short lines—operate more than 144,000 miles of track. As much as 41 percent of all intercity freight moves by rail, yet we generate only about 10 percent of freight revenues. This disparity between tonnage and revenues is explained by lower-rated bulk commodities, which make up much of what we carry. One of those commodities is coal; indeed, railroads carry two-thirds of the coal used to generate America's power needs and to fuel its factories. The automobile industry is a significant customer, too, with 70 percent of motor vehicles transported by rail. Chemical manufacturers, grain producers, and many other sectors of our industrial base rely on rail shipments. As you are keenly aware, passenger and commuter trains operate widely over the freight rail network, and we are constantly monitoring and maintaining our track infrastructure to ensure safety and reliability. Railroads truly do move America.

Railroads are important to the national defense as well. The Department of Defense counts on rail carriers to transport ordnance and supplies during peacetime and in times of war. The Military Traffic Management Command has designated the Strategic Rail Corridor Network, consisting of 30,000 miles of rail corridors, to be essential to the national defense. We work hard at our ongoing and close working relationship with the military to assure its capacity, security and equipment needs. The events of Sept. 11, 2001, called once again on our national defense obligations and were a grim reminder of the increased need to ensure the security of our bridges, buildings, dispatch centers, tunnels, storage facilities, and cross-border and port gateways. We are working within our industry, with our customers and with appropriate regulatory authorities to ensure that our transportation is conducted in the most secure manner possible.

Not to be overlooked is the environmental benefit railroads provide through reduced diesel emissions. Trucks emit from three to 12 times more pollutants per ton-mile than railroads, and traffic by rail means that fewer trucks must operate on our nation's highways. Railroads are three times more fuel-efficient than trucks, which helps to save energy and reduce our dependence on foreign oil.

Safety is, of course, our highest priority, and railroads are a very safe transportation mode. Rail has the lowest employee injury rate among all the modes. Over the last 20 years, the freight rail industry's diligence has resulted in a 64 percent decline in train accident rates and a 71 percent decline in employee injury rates.

At CSX, we operate an exceptionally capital- and labor-intensive business covering 23,000 route miles in 23 states, two Canadian provinces and the District of Columbia with assets that include 200 yards and terminals across the eastern half of the country, 3,600 locomotives and 100,000 railcars. Last year, we hauled 7.1 million carloads of freight more than 228 billion ton-miles. CSX is a significant part of the nation's rail freight network, and while my comments today will often reference my company, our experience is generally reflected across the industry.

At CSX, our stated goal is to be the safest North American railroad, and we are well on our way. From 2000 to the first quarter of this year, CSX has shown a 57 percent reduction in derailments and a 48 percent reduction in personal injuries. In a comparison of this year's first quarter and the same period in 2001, derailments were 25 percent lower, and we experienced approximately a 30 percent reduction in personal injuries. Safety continues to improve, as it must. We want our employees to go home in the same condition in which they arrive at their jobs. We want communities to trust us to operate safely, and investors, public officials and other constituencies to share that confidence. My testimony today will reflect that our safety efforts, as well as other important initiatives, rest upon our ability to invest properly in this capital-intensive business.

As I've shown, we are a vital component of the transportation infrastructure with a keen focus on commerce, national defense, the movement of passengers and commuters, the environment and, most important, safety.

The Impact of Regulation in a Changing Environment

In the mid 1970s, 22 percent of the nation's rail mileage was being operated under the gavel of bankruptcy courts. The equity markets were closed to the industry, and survival became a function of rate increases and deferred maintenance. By the end of the decade, the industry was becoming a wasting critical asset. Even those railroads considered healthy were suffering returns on investment that were dramatically below American industry in general. And with the high percentage of interline traffic—railcars exchanged among two or more carriers—even relatively healthy railroads often were forced to interchange time-sensitive freight with partners whose track conditions and service were substandard. Industrial assembly lines were affected and inventory costs soared due to inconsistent, unreliable rail service. The situation was exacerbated by locomotive shortages and reduced train speeds because of track conditions. The arrival of a railcar was something of a random event. As service deteriorated, market share spiraled downward and many shippers found other modes better able to satisfy their demands for reliable service.

Yet this ailing industry remained vital to the nation's economy, supplying some 37 percent of its intercity freight transportation, creating tens of billions of dollars worth of economic activity, and employing hundreds of thousands of workers. Clearly, something had to be done if railroads were to continue performing their vital role. Congress, shippers and railroads agreed that a solution addressing the fundamental causes was necessary. Nearly a century after the formation of the Interstate Commerce Commission in 1887, railroads faced extensive competition from other modes of transportation. Despite this intense competition, railroads were still regulated as if they were the pre-eminent mode of freight transportation. Rail rates were set collectively through rate bureaus and could not be raised or lowered without ICC permission. Contracts with customers, so prevalent in the rest of the American economy, were prohibited in the rail industry. In fact, rail regulation became even more stringent to the point that there was regulatory oversight for virtually every management decision. Fortunately, Congress began looking at sound policies that would address the forces that had combined to bring about the railroads' deterioration. Those studies led Congress inexorably to the conclusion that a successful railroad industry could be recreated only through some fundamental reforms, which resulted in the 1976 Railroad Revitalization and Regulatory Reform Act (4R). While a step forward, the 4R Act did not go far enough and additional action was required.

Staggers—A Workable Solution

The Staggers Rail Act of 1980 set out to reform the regulatory ills of the period by reducing some areas of regulation and preserving and enlarging others. Staggers recognized that railroads faced extensive competition in most markets, but that some shippers had fewer choices than others. Staggers addressed that situation by providing a robust regulatory environment to accommodate shipper interests where direct competition did not exist. The basic principle of Staggers recognized that railroads are a business and ought to be permitted to manage their assets and price their services appropriately so as to achieve revenue adequacy and reasonable profitability. Under Staggers, railroads were able to set reasonable prices that permitted needed re-investment, and negotiate confidential contracts with customers. In the new environment, safety and service improved, as did productivity, and damage to shipments was significantly reduced. With productivity increases, railroads were able to stabilize market share as measured in ton-miles.

Throughout the 1980s, railroads learned how to engage in direct competition and to expand their market reach through mergers and consolidations with stronger roads. Shippers benefited from these improvements, too. Most saw significant reductions in prices with the introduction of customer contracts that promoted rate and service negotiations and innovations such as unit trains, in which like commodities are grouped in a single train for a common destination, eliminating the need for intermediate switching. The fact is, an industry on the brink of collapse was put on the path to competitive vigor through a combination of self-help and the Staggers Act. Partial deregulation and mergers were viewed as the twin engines of railroad revival. Yet, a central fact remains: no Class I railroad to date has been able to earn adequate revenues on a sustained basis.

CSX and Staggers

CSX is a progeny of Staggers and bears witness to the positive consequences of this landmark legislation. Coincidentally, on the same day that House and Senate conferees approved Staggers—Sept. 23, 1980—the ICC permitted CSX to take financial control of the 11,000-mile Chessie System and the 16,000-mile Seaboard System. On Nov. 1, 1980, CSX was officially created and began operating the two systems under its corporate umbrella, though the two rail systems' operations were not completely integrated until 1986. CSX and the industry spent much of the 1980s adjusting to the newfound freedoms and challenges of Staggers, which included productivity gains, cost reductions and other efficiencies brought about by mergers. Short-line railroads were created as the larger systems shed unprofitable or marginally profitable track segments. These short lines preserved rail service to light density areas, and maintained rail employment for those who otherwise would have been forced to relocate or find other work. After a century-long decline in short lines, 226 new ones were created in the 1980s, a number that grew significantly in the 1990s. CSX produced many of those short lines as our system contracted from 27,000 miles in 1981 to approximately 18,000 miles in 1998, a reduction of about one third (prior to the acquisition of 42 percent of Conrail in the late 1990s.) Even after the Conrail transaction, CSX operated 23,000 miles in 2001, or 4,000 miles below the 1981 level.

With higher traffic volumes concentrated on an increasingly productive network, CSX found its groove in the 1990s with a sharper focus on its rail business and a renewed commitment to improve safety and service to our customers while lowering costs:

- Employee injuries were reduced, often by as much as 20 percent or more on a year-to-year basis;
- Service reliability was emphasized with process improvements and capital investment that included hundreds of more powerful and fuel-efficient locomotives;
- Costs were reduced with Performance Improvement Teams that identified best practices across the spectrum of American business and built action plans to address competitive gaps.

CSX's gains were impressive in the two decades that followed the Staggers Act, particularly in productivity and cost reductions, and that picture is reflected across the railroad industry. Between 1986 and 2001, CSX's revenue ton-miles grew by 62 percent, while the miles of road (including the effects of the Conrail transaction) remained essentially the same. We have significantly increased density as measured by ton-miles per mile of road.

Since 1984, CSX employees and managers have improved productivity by 88 percent. By contrast, according to the Bureau of Labor Statistics, the cumulative improvement in the national multifactor productivity indexes for manufacturing, private business and private non-farm business during 1984–2000 was 24.6 percent, 15.1 percent, and 12.6 percent, respectively. CSX indeed learned to do more with less.

Like all the other carriers, CSX has invested heavily in plant and equipment, which has reduced operating costs substantially. For example, locomotive horsepower capacity has increased by 27 percent since 1986 (from 9.0 million in 1986 to 11.5 million in 2001) while the total number of units remained virtually the same. Much of that is a result of purchases of locomotives using breakthrough alternating-current technology. More significantly, that 27 percent increase in horsepower—contributing to overall operating efficiency—enabled CSX to handle a 69 percent increase in gross ton-miles of traffic during this period.

CSX also has dramatically reduced labor costs while maintaining one of the industry's best relationships with its contract-covered employees. We have developed a New Compact with labor that emphasizes effective communication and openness, which has dramatically reduced misunderstandings and disputes. Our workforce has been reduced by 29 percent in the last 15 years, from 47,803 employees (measured by average employee count) in 1986, to 33,872 employees in 2001. This reduction also included the elimination of large numbers of administrative and support personnel, both contract-covered and managers. CSX also gained significant labor productivity by implementing crew-reduction agreements with labor unions that required substantial buy-out expenses in return for larger long-term cost savings.

Recent Industry Activity

The 1990s also included another round of significant industry consolidation. Despite intensive planning and numerous examples of precise execution, those acquisitions and mergers caused temporary but significant disruptions to service during their start-up phases.

The most recent major eastern transaction was carried out by CSX and Norfolk Southern, which began operating their respective portions of Conrail on June 1, 1999. Although there were starts and stops at the beginning, the assimilation pains and resulting service problems were largely resolved by early 2000. The integration has been successful for many months, and we are beginning to realize the potential of the acquisition of our 42 percent of Conrail. Safety has improved, service measurements are trending the right way, and almost all of the capital projects to produce those benefits are complete. In preparation for the Conrail transaction, CSX initiated a $220-million Capacity Improvement Project through Ohio and Indiana, including the construction of 100 miles to make the line double track along its entire length. New intermodal terminals were built in Chicago and Philadelphia. During the past year, we finished three major projects at former Conrail facilities that today are key points on the combined network: Avon Yard near Indianapolis, Frontier Yard in Buffalo, and Selkirk Yard near Albany. In the Chicago area, we completed improvements at Barr Yard. We are adding almost six miles of main track in northern New Jersey, a multi-year project that is now more than 50 percent finished.

Today, all of the key indicators of safety and operational performance are meeting or exceeding goals that we have set: employee injuries, derailments, total cars on line, overall train velocity, freight car dwell time in yards, and on-time departures and arrivals, among them. In recent oversight proceedings, the Surface Transportation Board recognized the significant improvements in CSX and NS service since the startup phase.

Reduced injuries and fewer derailments are resulting from employee coaching and training, a revolutionary approach to managing safety, and considerable investment in track, signals and infrastructure. Service performance in yards and terminals has improved steadily. Freight car dwell has improved by 35 percent from 2000 to the first quarter of this year. On-time train originations have improved 80 percent, and the percentage of trains arriving at their destinations on time has improved 136 percent. CSX has been emphasizing its local service to customers by measuring car placements or pulls within a specified customer window. Local switching performance during this time has improved 12 percent, and there has been an improvement of 111 percent in originating local trains on time.

Also during this period, overall velocity improved by 24 percent, and merchandise train velocity improved even more, by 34 percent. In terms of congestion as measured by the number of cars on line, the overall rail industry has achieved a 13 percent improvement since the beginning of 2000. At CSX, we have seen a 14 percent improvement in cars on line during the same time period.

To further service improvements, we have created industry alliances that promote fast transcontinental service. These alliances attempt to achieve some of the benefits normally associated with rail mergers and, if coupled with strong financial performance of existing carriers, diminish the likelihood of rail consolidations in the foreseeable future. We are hearing and responding to the additional demands of our customers, making ourselves easier to do business with by using e-commerce and other technology initiatives, and continuing productivity gains. We have translated those service improvements into modal conversion by offering economies and services that entice traditional truck customers to rail. One particular alliance is our Express Lane service with the Union Pacific in which we ship perishables and wine from the West Coast to markets in the Northeast and Southeast. With this alliance, we are producing truck-competitive transit times. Orange juice from Florida is another consumer product shipped on CSX. For a number of years, we have operated dedicated trains of orange juice from Florida to the Northeast and, more recently, to the Midwest. And we are re-capturing traditional rail products such as steel. Last year, we converted certain metals products to rail by soliciting business directly from the heads of the nation's financially pressed steel producers, creating significant savings for them and increasing our metals business. All told, we added more than 350,000 truckloads of freight worth more than $130 million to our railroad. This year's target is 450,000 truckloads.

CSX is characterized today by consistent improvement, and safety and operational metrics confirm this progress. The next frontier is a zero-injury, zero-accident railroad employing the latest technology to reduce transportation variation and improve shipment management. Our ability to innovate is seen in the recent development of a revolutionary new locomotive operating system designed to reduce fuel consumption and diesel emissions. Our own patented Auxiliary Power Unit could result in annual fuel savings of 30 million gallons once our entire locomotive fleet is equipped. In freezing weather, locomotive operators have always idled diesel engines to keep vital fluids from freezing. The APU automatically shuts down the main locomotive engine idle, while maintaining all critical main engine systems at greatly reduced fuel consumption. The U.S. Environmental Protection Agency recently recognized the APU with a Clear Air Excellence Award.

Through hard work and innovation, CSX and the rest of the industry have made enormous strides in improving safety, service levels and taking out costs.

Capital Intensity and Revenue Adequacy

Despite all this progress on so many fronts, we are haunted by the simple fact that CSX, like the rest of the industry, remains revenue inadequate, thereby failing to achieve the principal goal of Staggers and a key ingredient to the industry's need for sustainable growth. CSX and the other carriers have squeezed inefficiencies out of their systems, and the productivity and efficiency gains have been passed on to consumers in the form of lower prices. The Association of American Railroads data shows that more than two thirds of the industry's productivity gains have been passed through to customers, including those who describe themselves as "captive." The reduction in rates for our customers has applied to a broad range of commodities. For example, coal traffic has enjoyed significant rate reductions. On a revenue per ton-mile basis, CSX's coal rates since 1987 have fallen by more than 37 percent in real terms. Similarly, between 1987 and 2001 the average revenue that CSX received per ton of coal declined, in real terms, by more than 21 percent. These rate reductions are a direct consequence of the partial deregulation—and competition—mandated by the Staggers Act.

By giving railroads greater flexibility in ratemaking, you and your colleagues in the Congress appropriately made rates subject to marketplace disciplines. Intermodal, intramodal, geographic and product competition kept pressure on rates. Utilities today have tremendous market abilities by being able to shift production, wheel power and choose among competing energy sources. We face these competitive forces every day, along with other modal competition from barges, pipelines and trucks. Partial deregulation and changes in the trucking industry have greatly intensified its scope and effectiveness. The trucking industry has traditionally provided higher service quality with its inherent ability to deliver door-to-door and to choose optimum routing over subsidized federal and state highways and roads. As it should, competition acts as a marketplace regulator of our rates and service.

While declining rates may be short-term good news for shippers, they create significant hurdles for the railroads in terms of achieving revenue adequacy and sustaining growth. As recent history has shown, these lower rates come at a substantial cost to the rail industry as we remain revenue inadequate and unable to earn our cost of capital. Of course, businesses that do not earn their cost of capital are forced by the marketplace to shrink, whereas those that do earn their cost of capital produce growth for themselves and their customers. Since the Staggers Act was enacted, industry revenues have declined 42 percent (adjusted for inflation). CSX's recent experience is in line with the industry's own record. Since 1986, CSX's freight revenue per revenue ton-mile has fallen nearly 43 percent on an inflation-adjusted basis, and 17 percent on a nominal basis, as shown in the table below.

Year	Revenue per thousand revenue ton-miles (adjusted for inflation)	Revenue per thousand revenue ton-miles (nominal basis)
1986	$35.52	$35.52
2001	$20.33	$29.52

To address our needs for revenue generation and capital investment, and to capture more of the value that we provide the transportation marketplace, we have recently increased prices in selected markets. These price increases are built on the substantial service improvements and overall value we offer.

They also help to cover our enormous capital investment. Safe and efficient railroad transportation requires vast amounts of capital investment for track, signals, and structures; for locomotives and freight cars; for communications and data processing; and for technology application. Unlike federal highways, the inland waterways, and the nation's airways and airports, rail infrastructure is not subsidized. In future legislative debate, the question of dealing with modal inequities will be a critical one. When track is upgraded, when facilities are improved, when new equipment is purchased—rail carriers must make those expenditures. Freight rail carriers invest more than 20 percent of their revenues back into their systems, in comparison with other industry sectors that on average invest less than 4 percent of their revenues. And it takes more for railroads to earn revenues. Rail carriers require $2.72 in invested capital to generate just $1 in revenue. In comparison, the trucking industry requires 70 cents of invested capital to earn each revenue dollar. In addition to capital expenditures to improve and upgrade roadway, structures and equipment, railroads spend large amounts for routine annual repair and maintenance needs. These activities are just as critical to safe and efficient railroad operations as activities capitalized over multiple years.

Although CSX's capital investments have fluctuated from year to year, they have been substantial and have trended upward. Since 1986, CSX has made approximately $11.6 billion in capital expenditures, of which $7.1 billion was for road, $2.2 billion for locomotives, and $1.3 billion for cars and other equipment. CSX has generally increased the amount of its capital expenditures as it has generated additional total revenues. The amount of CSX's capital investments is particularly striking because these investments have been made even as CSX's revenue per revenue ton-mile declined from 1986–2001 by more than 40 percent on an inflation-adjusted basis.

CSX's capital expenditures for 2001, and the capital expenditures approved in its 2002 Capital Plan, are substantial. In 2000–2001, our railroad spent $840 million and $860 million in capital investment in each of those years, respectively. That compares to operating income of $713 and $847 million, and a free cash flow deficit of $373 million in 2000 and positive free cash flow of $77 million in 2001 (Conrail included). CSX's 2002 Capital Plan anticipates approximately $920 million in capital expenditures.

As I mentioned earlier, our industry needs to earn its cost of capital to achieve sustainable growth. The results for 2000–2001 show that we have invested heavily in our rail properties while achieving limited operating profits and, as seen in 2000, incurring a negative cash flow. Clearly, if we are unable to improve upon these financial results, the marketplace will dictate shrinking investment in our rail assets, and that would be detrimental to our customers, employees and core business.

With needed improvements to our revenue, we expect that the revenue adequacy shortfall will again narrow and, in fact, that has already begun to happen. In 2001, after three years of decline, CSX's return on investment was 4.6 percent—which represented an increase from the previous year's level of 3.6 percent. The gap between the 2001 return on investment and the cost of capital for that year (as calculated by the AAR) was 5.6 percentage points—below the gaps of 7.0 and 7.4 percentage points for 1999 and 2000, respectively. Similarly, CSX's operating income increased.

Nonetheless, the other factors that have contributed to the reduction in CSX's return on investment may continue. Both before and after the Conrail transaction, CSX's revenue levels consistently remained far below what would be required for its return on investment to equal or exceed the industry cost of capital. In 2000, for example, CSX's total revenues of $6.1 billion were *$1.065 billion* below the level that would have been required for the return on investment to equal the cost of capital.

Despite CSX's expectations that its return on investment will improve, and that the revenue adequacy shortfall will decrease in the future, the shortfall is likely to continue to be substantial. As I indicated previously, CSX has passed on a significant part of its cost savings realized through productivity gains to customers to remain competitive.

A recent report from the General Accounting Office to the House Committee on Transportation and Infrastructure confirmed that, for the period studied between 1997 and 2000, rail rates generally decreased. The Surface Transportation Board determined that the overall trend of declining rates is consistent with its own studies and analyses, and the Department of Transportation also agreed with the GAO conclusion. A substantial part of the remaining cost savings has been devoted to capital investment.

Although we continue to develop ways to improve productivity, we must realistically look to the future, recognizing that our large productivity gains of the past will likely not be duplicated absent unforeseen consolidations or technological advances. Thus, at this time, our industry's best hope to achieve adequate revenues is through a more aggressive focus on enhancing revenues, even as we continue our efforts to reduce costs wherever possible.

Facing the Future

Fortunately, demand for freight transportation is increasing. The Federal Highway Administration recently projected that demand for freight transportation will double over the next 20 years, with rail intermodal transportation estimated to grow almost 5 percent per year, the highest growth rate among the surface modes.

As CSX looks toward meeting our customers' needs in the future, we of course begin with the overriding goal of ensuring a safe, environmentally clean and efficient mode of transportation. A few weeks ago, this Subcommittee held a hearing to consider rail safety issues. CSX has specific action plans in place to achieve our goal of becoming the safest North American railroad and reaching our ultimate goal of zero injuries and zero accidents.

To meet safety and service goals, CSX must achieve a level of revenue and income that can attract capital at favorable rates and sustain our system in the long run. CSX's revenue-inadequate status makes it more difficult for us to attract capital. CSX must compete with all users of capital in the investment market, and therefore needs to produce a return on equity that is comparable to, and competitive with, other industries with similar risks. CSX, however, has consistently generated lower returns on equity than that of S&P 500 companies as a group. Unless we can produce this return on equity, CSX will find it difficult to fund all of the necessary capital expenditures.

Here, as a I mentioned before, that challenge will become far more difficult if certain parties are successful in persuading you to reverse the Staggers Act reforms and transfer more of the benefits to some customers at the expense of other customers and the railroads. When Staggers was introduced in 1979, Sen. Howard Cannon (then-Chairman of the Senate Commerce, Science, and Transportation Committee) noted that "most observers agree that economic regulation has exacerbated the railroads' problems." Then-Secretary of Transportation William Coleman described the pre-Staggers era as characterized by an "ever-expanding web of outmoded and often irrational economic regulation."

Of course, the Staggers Act did not completely deregulate railroads. In addition to retaining authority over a variety of non-rate areas, the Surface Transportation Board today has the authority to set maximum rates or take other appropriate actions if a railroad is found to have abused market power or engaged in anti-competitive conduct. This forms a "safety net" to address the needs of some customers who believe that their rail traffic is not subject to any effective competition. Nonetheless, some groups seek to jettison the regulatory reform that has worked so well and replace it with a kind of regulatory approach that has failed previously. While proposals to alter the current system of railroad regulation include different approaches, most of these ideas have been suggested in the past, some during your deliberations on the ICC Termination Act of 1995. Wisely, you rejected them.

The end result of these proposed changes is the same: the government would force railroads to lower their rates to favor certain customers while disadvantaging other customers, rail investors, rail employees, and the general public. These proposals would alter in a fundamental manner the nation's rail policy by artificially manufacturing rail-to-rail competition. By contrast, real-world decisions today about which markets will—and will not—sustain multiple railroads set the level of competition.

These proposals to undo the Staggers Act would wrest power from the marketplace and return it to the government. Control of the day-to-day operation of freight railroads would be stripped from the private sector, including the setting of rates, operating conditions, yard usage, and other elements necessary to provide rail service. By artificially requiring more competition than a market has shown is sustainable, legitimate competition eventually would be reduced. Railroads are already revenue inadequate and would be further behind if those proposals are successful. If demand-based pricing were eliminated as sought by some shippers, railroads would not be able to recover the costs of providing service across their systems. Shippers having the greatest demand pay a higher markup than do those with less demand, so that variable costs are covered and railroads are able to obtain different contributions to their high fixed costs from the most customers possible.

Every segment of the economy engages in this kind of demand-based "differential pricing." A business traveler pays more for an airline ticket obtained at the last minute than does a passenger on the same flight who was able to make a reservation days or weeks in advance. A movie matinee ticket costs less than a ticket for an evening performance, a fact that reflects the relative market demand for each viewing. The matinee crowd, with its lower demand for movies, benefits by watching the same movie for a lower price, but the evening crowd also benefits because the theater's fixed costs are shared by more movie audiences. In this way, evening viewers pay less than they otherwise would if theaters did not show matinees.

Railroads are no different from these and other businesses. The Staggers Act specifically identifies differential pricing as essential to the rail industry. Mandating that competition occur through governmental intervention would drive down rail rates to the point that full cost recovery would not be possible. Over time, the railroads would have to reduce their costs, either through foregoing maintenance, reducing the frequency or the quality of their service, deferring acquisition of new equipment, or by other drastic cost-saving methods. Ultimately, customers would lose service—precisely the opposite of the Staggers' goals and objectives.

Also of concern is legislation introduced seeking to change the so-called "bottleneck" cases at the STB. Under these proposals, a bottleneck railroad would have to agree to carry traffic only on the bottleneck segment of a route, even if it is able to serve the entire route and its rate for the entire route is reasonable. This is yet another attack on differential pricing. Consistently since at least the 1920s, bottleneck railroads have been able to choose how they want to route shipments and structure freight rates. In so doing, they perform like trucks and barges which favor their long hauls and avoid the inefficiencies of multiple carriers in a single movement.

But some shippers want to change the law to require a separate rate for the bottleneck portion. Then they could challenge the bottleneck rate as unreasonable under maximum rate regulation, even if the rate for the entire movement is reasonable. A shipper could thereby obtain competing rates for the non-bottleneck segment and combine them with the bottleneck rate. If this were to happen, the number of rate cases brought for resolution to the STB would skyrocket, and carriers would be deprived of the efficiency and revenue secured from their long hauls. Indeed, rates for non-bottleneck segments would be reduced almost to their variable cost, while regulation would limit the bottleneck segment rate. This would result in a huge revenue loss for rail carriers that would not be offset by expense reductions. This legislation would take us back to where we have already been, to a world of stifling rules, crumbling infrastructure and overriding safety concerns.

These assaults on differential pricing all have fundamentally the same result: preventing railroads from earning revenues sufficient to operate their systems efficiently and making investments in the infrastructure necessary to remain competitive and operate safely.

The future of the railroad industry is one of cautious optimism, based on the successes since the Staggers Act and the trends toward productivity improvements. I suggest respectfully that you in Congress must make fundamental decisions about the industry. Will it be an industry characterized by marketplace decision-making where customers have the opportunities to move their products at fair rates, and carriers are fairly compensated for their service? If so, we will see reinvestment of revenues in capital spending and efficient, productive rail operations. On the other hand, if unnecessary regulations and governmental intervention instead burden the rail industry's future, their harmful effects will again impair service to customers and deprive railroads of sufficient revenues to cover the costs of the national rail system.

Conclusion

I urge the Subcommittee to focus on the future and to ensure that this industry, which is such a critical element of the nation's infrastructure, is able to achieve sustainable growth and appropriate reinvestment. Although the debate over economic regulation will continue, the record of Staggers is clear. Staggers has worked very well for the vast majority of the shipping public, with improved service and reduced rates. For the railroads, Staggers has fostered further competition and a new focus on the need to achieve revenue adequacy. At this juncture, the railroads have produced good results and shared them with the shipping public. However, the carriers now need to improve their revenue adequacy to ensure their continued investment in plant and people and their future profitability. Changes to Staggers now sought by certain shippers would only threaten our ability to provide safe, efficient and economical rail service and disable our return to a sound economic base. Rather than reversing our progress, we should now more directly focus our energies on fostering investment in rail infrastructure through both traditional capital markets and transportation policies that eliminate current biases against rail freight.

Mr. Chairman and Members of this Subcommittee, please let me assure you that we at CSX will continue our efforts to provide our customers with the safest, most dependable service possible. We ask you to resist the calls by some to intervene in the marketplace, and we urge you to stay the course on the Staggers Act. The genius of the law today is that it delicately balances the legitimate interests of shippers in having dependable service at fair rates with the understandable need of railroads to earn sufficient revenues to reinvest in their highly capital-intensive infrastructure.

I appreciate the opportunity to appear before you today, and would be happy to answer any questions.

Senator BREAUX. Thank you, and I thank all the panel, and once again, many of you have traveled some long distances to be with us. I appreciate it. Terry, thank you for coming, particularly, from Louisiana.

I think in the Staggers Act we tried to set up a process that would say that when shippers think the rates that are being charged are unreasonable, there is a mechanism to be heard and to get redress from unreasonable rates. You all may have summarized this very well. Can anybody just tell me why that does not work?

I have met with you individually, but for the record, why does a system that we set up that we thought was going to be the system to address unreasonable rates, in your opinion does not work? Anybody want to take a stab at that?

Mr. SCHWIRTZ. I will take a stab at it.

Senator BREAUX. Arizona?

Mr. SCHWIRTZ. Yes, sir.

I think a couple of things. We are currently in a case, as you know. We tried to negotiate that case with the railroads prior to, and outside of the STB for over a year and a half, and were not able to achieve any type of negotiated settlement on rates, and to avoid the regulatory process. The reason we tried to do that is because the regulatory process is so ominous. We are not a big company. We do not have a lot of revenue in our company, and it is very difficult, very costly, and there is a lot of risk of going through the STB regulatory process, so we tried to avoid that at all costs.

Senator BREAUX. So the time and the cost are two of the big impediments that you see?

Mr. SCHWIRTZ. That is two of the big impediments, and the risk of not knowing what you are going to get after you invest the time and the cost.

Senator BREAUX. You heard me suggest, to the Chairman of the STB, Linda Morgan, about the possibility of looking at arbitration. I am just throwing something out here. It may be off the wall.

But instead of going through this long drawn out legal fight, where the winners may be all the lawyers that everybody has to hire, and the economists and everything else, to kind of somehow set up an arbitration deal. We do this in other areas. We have been debating medical malpractice on the floor of the Senate, and arbitration has been used in many States to resolve these disputes before they have to go to court and be drawn out.

Is the concept of the STB supervising arbitration between the carriers and the shippers something that should be pursued? Is that a possibility, Mr. Platz?

Mr. PLATZ. I can make a comment on it. We also have operations in Canada, so we have two plants up there, and there are two railroads that serve Canadian shipments.

In Canada, they have mechanisms to address two of the issues, and actually three of the issues that have been discussed today. One is bottleneck, another is terminal access, and finally the rate adjudication.

Senator BREAUX. How do they do it?

Mr. PLATZ. They have arbitration, and it is a fairly simple thing. It is not very costly, and it is very effective.

Senator BREAUX. Is it speedy in comparison?

Mr. PLATZ. It is very speedy, but what it does do is, it forces both the shipper and the carrier to really work together. In other words, they know that sitting behind there is going to be an arbitration of these rates. Now, most customer supply relationships would like to settle that themselves, but they know there is a mechanism that backs them up, so normally these rates really do not get to the arbitration. They are settled between the customer and the supplier. In other words, there is a healthy relationship which is established because the arbitration sits there.

Senator BREAUX. Maybe a forced healthy relationship.

Mr. PLATZ. Exactly.

Senator BREAUX. But the result is the same.

Mr. PLATZ. Is the same. Now, we have not used the STB system to settle rate disputes, but we have used it in Canada.

Senator BREAUX. You have used it in Canada?

Mr. PLATZ. We have used it in Canada, and it works very effectively.

Senator BREAUX. Now, John, Mr. Snow, what is the railroad industry's take on that suggestion?

Mr. SNOW. Mr. Chairman, I am not sure we have given that the thought that would be required to really have a take on it. We do not operate in Canada to any degree, so I am not really familiar with that Canadian system, but it is certainly something to be looked into. It seems to me we ought to have a position on that.

Arbitration, though, should occur against a backdrop of some controlling principles like those found in the Staggers Act.

Senator BREAUX. Let me ask this, if I could, of both Mr. Snow on behalf of the railroads and some of the witnesses here. If you all could possibly get together without antitrust implications and see if each of the two sides could maybe explore that concept a little bit further as a way of resolving unreasonable rates. In your opinion through an arbitration type process, what would the shippers like to see in that process?

And then Mr. Snow, on behalf of the railroads, if you could coordinate with your colleagues, if Congress moved in that direction, what do you think would be part of that type of a system that you all would feel comfortable with. Any system has to be fair to both sides. That would be helpful.

If we could ask you all, especially Mr. Platz, you seem to be familiar with it. If you could coordinate with your colleagues from that perspective, and anybody else you want to bring into it who would be helpful and then Mr. Snow obviously can do that with the railroad industry. Maybe at least let us explore this.

What we have here is an effort by the Committee we have had three hearings on this. This is something we normally do, we do not spend that much time on one subject. We generally have one hearing and move on, but this is the third hearing just on this type of an issue, so the Congress is very serious about it.

We have heard from the Huvals and the Schwirtzes and everybody else back home. We want to make sure that we have a viable railroad industry at the same time, but this is not insurmountable, so I want to ask both sides, if we can, to explore this further and see if we can make some recommendations for this Committee to do.

Any other comments from anybody?

Mr. SNOW. Senator, I will commit to undertake to follow up on your suggestion.

Mr. PLATZ. I will do the same.

Senator BREAUX. OK. Thank you, Mr. Platz.

Yes, sir.

Mr. STREGE. Mr. Chairman, you are correct about the process not working very well. Mrs. Morgan talked about a case that had gone on for 16 years. That is from up in my part of the country, Montana, and that sort of a thing has intimidated shippers from filing rate cases.

Filing fees were mentioned. Yes, they have to be kept in check, but that is just the start of it. Then you have the lawyers and the cost accountants and so forth.

One of the things about arbitration, I think that we have to make sure does not happen is that the small shipper is not overwhelmed with information, or that there is a discovery process that could be used by the railroad to frustrate the small shipper. I do not want to take anything away from the large shippers, but we are basically an industry of small operators, so we are sort of at a disadvantage in that respect.

Senator BREAUX. Well, I thank each and every one of you for being with us. The testimony is good. I have read all the testimony. I have met with all the witnesses, and you have a very interested Senate Commerce Committee on this. I can pledge that something is going to happen. I do not know yet what, but something will.

I thank you, and with that, the Committee will be adjourned.

[Whereupon, at 11:50 a.m., the Subcommittee adjourned.]

APPENDIX

PREPARED STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Mr. Chairman, thank you for holding this hearing today. Rail competitiveness has been an issue that has come before this Committee on many occasions, and more frequently over the last five or so years as just about every major railroad struggled with some self-inflicted service problems.

But concerns among the rail customer community about growing railroad monopoly power have not been limited to times of service crises. Many of us on this Committee have continued to be called upon by our constituents to use our policy-making powers to enable customer choice to all users of rail transportation.

At the beginning of this Congress, this Committee embarked upon a series of hearings that focused on the concerns the various stakeholders has about railroad competitiveness. As part of this series, we've heard from Surface Transportation Board Chairman, who has testified that the Board is implementing the law as it is written and that any changes on how to address competitiveness issues will require action by Congress.

We've also heard from representatives of the largest railroads, who oppose any changes that would impact their regional monopolies, claiming there's no other way for them to operate and make money, which is the same argument that's been made by every other industry monopolist we've ever heard from.

I encourage my colleagues to listen to today's witnesses. Once you have heard their statements, you will agree that it is high time to move forward in giving serious consideration to what legislative actions we should take to resolve this impasse. All rail customers—not just a select few—should be able to make competitive choices, or at least begin to be able to negotiate with their rail carriers on a more balanced playing field.

Last year, I joined with my colleagues Senators Rockefeller and Dorgan to introduce S. 1103, the Railroad Competition Act of 2001. After further discussions with my constituents and other Senate colleagues, I decided to introduce S. 2245, the Railroad Competition, Arbitration and Service Act of 2002, which as been cosponsored by Senators Craig, Crapo and Baucus, as another possible alternative along the lines of approaches adopted by this Committee in bringing competition to other network industries.

And there may yet be other policy approaches out there that may deliver competitive choices to rail users. One thing's for certain: regionalized monopolies over rail transportation are not good for shippers, or for railroads, or for railroad investors or for our respective state economies, or for our national transportation network as a whole. Furthermore, this problem will not go away.

Given the lateness of the legislative session, I recognize that reaching a consensus within this Committee this year on how to modify federal rail policy is unlikely. In the meantime, however, I hope each Member of the Committee will begin exploring these issues independently and in anticipation of Committee action on this issue next year. I'm sure all of us who have attached our names to legislation would like for the Chairman to commit to holding a hearing at the beginning of the next Congress that specifically explores possible solutions that will address the concerns we all hear repeatedly from our captive rail constituents.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF DIANE C. DUFF, EXECUTIVE DIRECTOR, ALLIANCE FOR RAIL COMPETITION, INC.

On behalf of the members of the Alliance for Rail Competition, I respectfully request the following statement be included in the official record of today's hearing.

The Alliance for Rail Competition represents captive rail customers moving primarily coal, chemicals and grains. Much of the reason these rail customers have so little rail-to-rail competition can be traced back to regulators, and we have a long,

long history with regulators. In 1887, after years of monopolistic market abuses and inadequate state regulation, railroads in the United States came under federal regulation through enactment of the Interstate Commerce Act. Eventually, these controls became overly burdensome as the over-built railroad industry faced increasing competition from motor carriers, spurred by the development of the interstate highway system.

Recognizing the growth of such intermodal competition, the Staggers Rail Act of 1980 deregulated much of the industry. But the Staggers Act was not one-sided. It was intended to implement a balanced public policy whereby regulation would be eliminated where competition prevailed, and competition encouraged where absent. Regulation was to be a poor, second-choice, safety net.

Instead, regulators have interpreted the law in such a way as to virtually eliminate rail-to-rail competition, which has left approximately 30-percent of rail customers subject to railroad monopoly behavior because they cannot realistically turn to other modes of transportation. Furthermore, regulators have done little to provide a safety net for those whose competitive choices have been eliminated.

Among other policies, the Staggers Rail Act was to allow competition to establish reasonable rates, to ensure effective competition among rail carriers, to reduce barriers to entry, and to avoid undue concentrations of market power—in essence, to promote competition as the basis of fulfilling the needs of railroad customers. And yet, just the opposite has occurred.

Mergers and Acquisitions

Through mergers and acquisitions, the 36 Class I railroad systems that existed in 1980 have been reduced to seven, with four overwhelmingly dominating the industry. In 1980, the four largest railroads accounted for 43-percent of the industry's traffic, whereas in 1999, the figure had increased to 95-percent. These consolidations have permitted railroads to eliminate duplicate facilities and reduce their miles of track owned by 40-percent, from 165,000 miles in 1980 to an estimated 99,000 miles in 1999. At the same time, the consolidations resulted in the development of four regional monopoly infrastructures, in most cases without providing for service competition over those track structures. By allowing railroads to "tie-in" their operational service to the exclusive use of their fixed facilities, regulators have limited the competitive goals of the Staggers Rail Act to apply to only those customers who can use another mode of transportation.

The Railroad Pricing Myth

Various studies have been released over the years—by the STB, the GAO and the Association of American Railroads—claiming that, despite the emergence of regional monopolies, rail rates have been declining for 20 years. The railroad industry has consistently used these studies as props to claim that rail customers have no reason for complaint. However, these reports rely heavily on data that does not measure the changes in actual railroad freight rates, but rather adopts a "freight revenue per ton-mile" (R/TM) financial measure as a surrogate for the general level of railroad freight rates. This is an improper use of that measure. History shows that railroad freight rates have often increased as R/TM declined, because R/TM is affected by a multitude of factors other than changes in freight rates. As the railroads have become more concentrated, they continue to offload rail costs onto rail customers. Railroads now make some customers invest in cars, larger and larger loading facilities, weighing devices, inspection facilities, and even locomotive power. Since the rates now don't include these components the railroads claim they are lower, when in fact, the rail customer is paying ever-increasing shares of the transportation cost.

Furthermore, it is not the general level of railroad rates that should be of concern to policy-makers. The development of effective regulatory policies requires the analysis of railroad rates in individual markets, relative to operating expenses and service levels in those markets. What is consistently lost in these reports is that rail-dependent customers have incurred higher, albeit constrained, railroad freight rates. Furthermore, there has been no established means for measuring the differences in the service levels over the years provided by individual railroads to captive customers versus those who have competitive choices.

Policy Actions

As the number of railroads serving any one market has dwindled from several to only one or two, very little has been done to balance this consolidation by implementing increasingly competitive policies. It is true that when rail mergers result in a particular market going from two rail carriers to just one, the STB has placed conditions on those mergers. However, the erosion of competition began long before any given market has faced becoming singly served, and nothing was done. Despite clear statutory language directing regulators to encourage competition to the *max-*

imum extent possible, regulators seem to have an overly narrow view of their responsibility to protect existing or encourage new competition among railroads. There were many policies that could have been modified over the years to address this dwindling amount of rail-to-rail competition, but instead protective policies were either adopted or left in place. For example:

- Under 49 U.S.C. 11102(c)(1), the STB may require rail carriers to provide switching in terminal areas where it finds such agreements "to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service." Yet, despite its broad statutory authority, the agency has significantly narrowed the focus under its "Competitive Access Rules." Since these rules were promulgated in 1985, there have been six decisions further interpreting those rules as they pertain to shippers. The result: Shippers have not won a single decision, and the agency has never granted a competitive access remedy in favor of the shipper under those rules.
- The STB, and its predecessor, have consistently condoned the act of Class I carriers creating "paper barriers" when spinning off a branch line to form a shortline railroad. A paper barrier essentially prohibits the newly created "independent" shortline from interchanging traffic with any railroad but the parent carrier. As a result of paper barriers, the shortline and regional railroad community can also be captive to Class I carriers.
- The STB determined that railroads are fully within their right to exploit customers located on a bottleneck. A "bottleneck" is a segment of rail track that serves either the point of origin or the point of destination in any given route. Because the bottleneck is controlled by one railroad, that railroad can force any customer that needs to move goods over that portion of track to use only that railroad's services over the entire route, regardless of whether a second carrier may be available to provide competing service for a majority of that route.

Had these policy questions been approached differently, regulators could have made significant progress in offsetting the reduced rail-to-rail competition sanctioned through government-approved mergers. Alternatively, regulators could have decided to undertake a rulemaking that would have modified their previously adopted policies in light of a changing rail industry. Instead, regulators continue to adhere to the view that they have done what is required by the letter of the law, and any modification will require Congressional action. In light of the government-sanctioned franchise held by railroads, Congress must act to correct the balance between captive rail customers and their railroads.

The Captive Rail Customer's Experience

While the nature of the captive shipper experience is different for every company depending on their size, location, and commodity shipped, railroads impose their monopoly over their captive customers fairly consistently. Generally, companies that try to negotiate reasonable rail rates have been told by their railroad representatives that the railroad would rather see the company go out of business than accept lower, more competitive rates. Companies ordering rail cars often don't receive them for days, sometimes weeks after expected. Then when they do arrive with little notice, rail users must be prepared to fill those cars within 24 hours or face substantial demurrage fees, even though the railroads may not return for weeks to pick them up. In case after case, the largest railroads are shifting responsibility for switching at the loading or unloading facility to their customers, allowing cost reductions that allow them to continue to conjure up data that appears to demonstrate that "rates" are falling when in fact they are showing merely an average of a complex array of cost data. And in the most blatant exercise of monopoly power, grain shippers throughout Montana, North Dakota, South Dakota, Idaho, Washington and Oregon have watched as the BNSF has wreaked havoc with their export wheat market. Steve Strege's testimony discusses the BNSF's discriminatory inverse rate scheme in great detail. The bottom line is that growers in these states have lost millions due to the BNSF's interference in their markets, and may lose more depending on how their dissatisfied customers' spending patterns change as a result. Although the grassroots efforts undertaken by ARC members in those affected states has succeeded in pressuring BNSF to suspend its inverse rate pricing scheme for now, there's little to prevent BNSF from re-instituting this discriminatory and market-damaging pricing structure at any point in the future because there is no rail competition in these markets.

Individual Rate Cases

While there is virtually no relief for service related problems outside of an informal intervention by STB personnel, captive customers do have the option of pursuing resolution to rate related problems before the Surface Transportation Board. For the largest shippers—predominantly coal shippers—the rate case approach has been somewhat successful. Even though it takes upwards of two years and millions of dollars to argue a case, and tariff rates applied to their coal movements while the rate case is under consideration are substantially higher for the duration of the case, there have been some successes for large coal shippers.

This is primarily because coal shippers are moving unit trains back and forth between two points. Large shippers of various other commodities that move between numerous origins and destinations have a far more complex situation, and would have to argue each rate complaint route-by-route. And the economics of a rate case for smaller shippers—whether they are shipping smaller volumes or they themselves are relatively small—simply don't work.

Consider: In 1996, the STB adopted rate guidelines for non-coal proceedings as a recognition that the regulatory framework used for analyzing rate challenges was so lengthy and costly as to be prohibitive in cases where the amount of money at issue was not great enough to justify the expense. The STB decision identifies three revenue-to-variable cost benchmark figures as starting points for determining the maximum rate for small shippers:

1. The "Revenue Shortfall Allocation Method" (RSAM) benchmark is intended to measure the uniform markup above variable cost that would be needed from every shipper of potentially captive traffic in order for the carrier to recover all of its fixed costs.

2. The "Revenue to Variable Cost Comparison" (R/VC Comp) benchmark is intended to provide a means of reflecting demand-based differential pricing principles. The benchmark measures the markup taken on traffic priced at greater than 180-percent revenue/variable cost that involves similar commodities moving under similar transportation conditions.

3. The "Revenue to Variable Cost greater than 180" (R/VC 180) benchmark is intended to measure the degree of differential pricing actually being practiced by that carrier (i.e. the extent to which the carrier is marking up its "greater-than-180-percent r/vc" traffic on average). The purpose is to consider the fairness of the defendant carrier's rate structure to ensure that the complaining shipper's traffic is not bearing a disproportionate share of the carrier's revenue requirements vis—vis other relatively demand-inelastic traffic without good cause.

While these three tests may seem commonplace among regulators, they are fraught with uncertainties that act as significant deterrents to testing the guidelines. First, they all require varying degrees of expert analyses, which is quite costly. In addition, one of the three factors depends upon access to the confidential waybill sample data, and you can't get access to the data unless you file a complaint. Finally, the STB's decision does not indicate how these three factors will be weighted or if they'll even be used, which makes it difficult to make an informed judgment as to whether pursuing such a rate case is worth the time and money at risk. While the Board has recognized that there are instances where its coal rate guidelines would be an unreasonable burden, there has never been a decision by the Board about what cases would qualify to use these alternative guidelines, so a shipper doesn't even know if he can qualify to use the rules. It is also worth noting that experts in rail economics have estimated that the best possible outcome for a rate case filed under the small shipper guidelines would be a rate of approximately 230-percent of variable cost—well above the legislated threshold of 180-percent. This sort of disparity would seem to reflect that—illogically—regulators have determined that smaller shippers should bear greater burden for railroad costs than larger shippers.

These factors create a natural disincentive, particularly for smaller shippers, to pursue a regulatory remedy, and this is borne out in the record: despite numerous public complaints, no shipper has ever attempted to file a case under these guidelines. This should not be surprising considering that, regardless of size, shippers on the whole consider the Board's rate complaint processes to be too lengthy, costly and complex. (In a GAO survey, 75-percent of surveyed shippers believed that they were charged rates they did not consider reasonable, but asserted that barriers to seeking rate relief precluded them from using the Board's rate complaint process.)

The Board could be given credit for its modest attempts to streamline rate cases and enhance competition, such as its 1998 decision to eliminate product and geographic competition factors from the market dominance determination process and its 2001 merger policy changes which at least pay lip-service to the need for competitiveness. But why shouldn't its efforts have been more aggressive? And as the agency charged with regulatory oversight of the rail industry, why has the Board not requested additional authority to rectify what has clearly become an anti-competitive environment? Some rail customers have suggested that the Board has been overly influenced by the railroad industry. Regardless of the reasons, the Board's behavior reinforces the need for Congressional action to clarify the statute and rebalance the scales between the needs of railroads and the needs of their customers.

What Rail Customers Want

In the simplest of terms, rail customers want to be able to make choices based on service quality and price. After years of STB statements reinforcing that it cannot or will not act to grant all rail customers the opportunity to choose among rail carriers for rail transportation services, only Congress has the power to allow rail customers that basic principle that drives virtually every other industry that makes up the U.S. economy.

The data show that approximately 30-percent of rail users are paying rates that indicate captivity—in other words, the rates are high enough that if some other option were available to that customer, it is likely that the customer would exercise those options. Although it is reasonable to assume that approximately 70-percent of rail customers do have some amount of choice based on this data, there is too much emphasis on competition as a policy direction within the existing law to believe that Congress endorses a policy that would leave so many rail users captive to one railroad.

Despite the drastic consolidation that has occurred over the last 20 years, there are a number of options that would significantly improve the current monopolistic environment. Furthermore, most of these options have been applied in some form with great success either to railroads in Canada or to other heavily capitalized industries in the US.

- **Final Offer Arbitration (FOA).** Already in place in Canada, and used in many private sector situations throughout the U.S., FOA encourages private sector negotiations to resolve disputes. If the dispute still cannot be resolved through negotiations, one or more neutral arbitrators can be called upon at the request of the disputing party to determine in a short period of time whose proposal is most reasonable. This process would allow a more cost-efficient alternative to the existing lengthy and costly rate case, and balance the playing field between railroads and their captive customers.
- **Bottleneck Relief.** By granting rail customers the right to receive a rate quote over a bottleneck segment, those customers could have the benefit of competitive choice over a major portion of their route(s).
- **Elimination of Paper Barriers.** Paper barriers prohibit smaller carriers from working with their customers to develop the most efficient route according to the customer's needs. There is no difference between a Class I railroad telling an independent shortline that it must use the Class l's infrastructure and Bill Gates telling computer makers that they must install Microsoft's browser is that Bill Gates and Microsoft. However, Microsoft is subject to anti-trust laws, whereas railroads are exempt and carry the power of a government-bestowed franchise.
- **Trackage Rights.** Trackage rights are used every day by railroads at their own discretion. Furthermore, trackage rights have been successfully imposed on portions of the Union Pacific as a condition of its merger with Southern Pacific, with no operational or safety problems. There is no reason why trackage rights should be available nationwide, and market forces can determine where trackage rights make the most sense. This principle is a widely accepted approach that has been central to Congressional efforts to deregulate other network industries, such as telecommunications and electric utilities.
- **Open terminal switching.** Some argue the law already allows this, but as noted previously, the Board does not adhere to that interpretation. Nonetheless, a similar concept has been successful in bringing competitive choices to Canadian rail customers that are proximate to terminal areas. Furthermore, this is not dissimilar to the shared asset areas established as a condition to the division of Conrail between CSX and Norfolk Southern.

All of these concepts have been fleshed out in legislative language either in S. 1103, introduced by Senators Dorgan, Rockefeller and Burns or in S. 2245, introduced by Senators Burns, Craig, Baucus and Crapo. These bills deserve to be explored fully and acted upon by this Committee, particularly since an extensive hearing record exists demonstrating that rail customers' complaints are not regionally limited, nor are they limited to a particular industry.

If we can agree that there are enough problems to warrant numerous Congressional hearings over the years, shouldn't we now be moving toward a more extensive discussion of the solutions and how to best implement them? Competition won't ruin railroads, but lack of action to get rail-to-rail competition in place will definitely have negative effects. Railroads will tell you today's policies benefit the public because there is no other way to earn the revenues necessary to sustain their high fixed-cost/low return businesses. This is simply not true. After all, even since the Railroad Revitalization and Regulatory Reform Act of 1976 enacted the annual revenue-adequacy determination, the railroad industry has never achieved revenue adequacy. This alone should highlight the need of railroads to seek an alternative approach to financial viability.

Yet, over the past 20 years, railroads have been deregulated, downsized to the tune of saving tens of billions of dollars, shed of their uneconomical branch lines, described by the president of the Association of American Railroads as being in the second "golden age of railroading," projected to save billions of dollars from mergers and acquisitions, self-promoted as the most productive railroad industry in the world, and re-monopolized to where four railroads account for over 95 percent of industry traffic. Furthermore, over the past eight years, the economy has sustained record growth and financial soundness. Given the state of railroad revenue inadequacy during such boom times, one can rationally conclude that cost cutting alone will not result in a rosier financial picture. Thus, it would be prudent for the railroads to explore ways to enhance revenue—specifically, by renting excess capacity in order to grow the traffic, increase asset utilization, and consequently add revenue.

Additionally, many, many industries with similar cost structures function quite successfully in a highly competitive environment. They have figured out how to differentially price their services according to customer demands rather than monopoly control. Railroads refer to what they do as 'differential' pricing when in reality all differential pricing in all other industries is based upon consumer demand, whereas in the rail industry differential pricing is really 'discriminatory pricing' because it is based entirely on the level of captivity of the rail customer. The key is being willing to listen to your customers, providing the various tiers of services that will meet their needs, and pricing those services accordingly. For railroads to do this, they need to apply innovative solutions to their rampant service problems. We believe increased competition will cause the railroad industry to take the initiative to learn about the potential market and financial opportunities associated with a new customer-driven business model. Competition has regularly provided the necessary incentive for other former monopoly industries.

Thus, the Alliance for Rail Competition urges this Committee to begin exploring the various legislative proposals that have already been made to resolve the litany of problems that rail customers face as a result of the lack of rail-to-rail competition. No one in the rail customer community believes that the Congress ever intended the rail industry to transform into regional monopolies, nor do we think it likely that the Congress finds the current state of affairs acceptable. These are complicated issues, made more controversial by the railroad industry's unwillingness to respond to its customers needs. But left unattended, this situation will not go away. In fact, it very well may get worse if and when additional major mergers are proposed.

Thank you for your consideration.

PREPARED STATEMENT OF DAN S. BORNE, PRESIDENT, LOUISIANA CHEMICAL ASSOCIATION

The Louisiana Chemical Association (LCA) is a Baton Rouge, Louisiana-based trade group representing chemical manufacturers doing business in the state.

Unless Congress addresses rail reform issues quickly and substantively, the competitiveness of our facilities will be severely impinged and the result will be layoffs and a deterioration of our productive capacity.

The LCA represents 67 member companies operating at approximately 100 different manufacturing sites across Louisiana. LCA members employ nearly 30,000 men and women who use their training, education, and experience to manufacture safely the building blocks of our modern, safe, and convenient lives, producing everything from antibiotics to zoom lenses. Tens of thousands of other Louisiana citizens work in support businesses that provide the state's petrochemical industry with everything from pumps to paper clips to construction and maintenance services.

Chemical manufacturing is a huge economic engine for Louisiana. It accounts for some 40 percent of all the value that is added in the state's manufacturing sector, shipping $20 billion worth of products annually.

Today you will hear from a panel of outstanding witnesses and in submitted testimony about the high-handed, "take it or leave it" attitude of some railroads: "*Take* the rate to move your product, or we'll *leave* it in your plant."

The chemical industry is at risk if railroads that hold some of our plants hostage are not compelled to offer rates that recognize the economic facts of today's manufacturing life.

Louisiana is the third largest producer of chemical products in the United States, ranking behind Texas and New Jersey. LCA member companies receive raw materials and ship products by all transport modes, but they depend most heavily on water and rail. The reality of the Louisiana situation is that in many specific situations, chemicals *must* move by rail due to product characteristics; distance; customer preference; shipment size; or other factors.

As major shippers of petroleum, base chemical, feedstock, and other bulk commodity products such as alumina and fertilizer, our members have a significant interest in working to resolve service problems that have evolved during the steady consolidation of the American railroad industry since 1980.

The LCA therefore asks the Committee to address several rail rate and oversight areas that we feel need reform if our industry is to remain competitive and grow the *American* economy, not some other country's.

What, then, are the problems?

One problem is that our members suffer from a lack of railroad competition. Sometimes the problem exists because there simply are no transportation options to a single railroad physically available. The plant in this example would be "captive" to the railroad.

"Hostage" is a better word.

One of our plants recently got a rate increase notice from the railroad that would have raised the shipping rate to an amount equal to the delivered price the company was getting for its product! After a lot of noise, and after Congressional interest was shown, this plant was finally able to negotiate the same increase, but over three years instead of one, an effort to keep its manufacturing unit running.

Otherwise, the high-handedness of the railroad, unilaterally imposing a rate hike, would have resulted in people at this plant hitting the bricks and heading to the unemployment line.

What happens to a plant that is captive to a certain railroad and has no viable transportation alternative because competitive alternatives are not physically available?

To be brutal about it, captive customers pay the most and receive the worst service. LCA members have suffered from poor service; delays and excessive transit times; high freight costs; and other disruptions that have put Louisiana manufacturers at a competitive disadvantage.

At other times, there is the possibility of railroad competition only a short distance from the plant, but the railroad serving the plant will not allow access to that competing railroad. This is called the "bottleneck" problem.

Several chemical companies in Texas, for example, *are building their own railroad* to overcome these kinds of problems! This is a misallocation of capital resources that could be better invested to make plants more competitive, but the companies simply have no choice.

We commend the Committee for recognizing this critical issue and thank it for adopting the amendment to S.1991 that would allow captive shippers access to railroad infrastructure and loan guarantees. It would be instructive for the Committee to revisit the railroad industry's position on this build out amendment.

In Louisiana, however, as Senator Breaux and Senator Landrieu well know, because of sensitive wetlands issues, a plant or group of plants may have no way to build their own track. The ultimate solution, then, is to force the railroads to solve the bottleneck problem by requiring them to de-bottleneck their systems.

These problems are the direct result of consolidations in the rail industry and the status quo that protects the railroads from rail to rail competition. The railroad industry is the only deregulated industry in the nation that is not subject to the antitrust laws and is allowed to take actions to block its customers from gaining access to railroad competition. The Congress or the Surface Transportation Board therefore must change the STB's 1996 "bottleneck" ruling. One solution that we favor is requiring railroads to quote rates across their bottleneck facilities to competing rail systems.

In fact, Mr. Chairman, the captivity that some of our chemical companies experience due to bottleneck problems is being projected onto their plants that have competitive options through railroad “bundling”. Under this mechanism, the railroad that has one plant captive will offer to charge a lower captive rate if the company will sign a transportation contract for their second, competitive plant—at a rate higher than they would otherwise need to pay in their competitive situation. One of our companies recently refused to yield to this “bundling” pressure and signed a contract at their competitive plant that includes rates 15–25-percent lower than the rates they had been paying under the “bundled” contract. Immediately, their rates at the captive plant escalated in double-digit figures and they were threatened with a new policy of “cash in advance” for their shipments if they did not cooperate. Congress needs to address the problem of “bunding” that results in captivity being projected onto competitive plants.

Members of the Committee, there is yet another problem that presents itself when a captive shipper is faced with a unilaterally imposed rate hike. The company has the option of filing a rate case with the STB.

In fact, rate cases are not a possibility for our chemical plants. They are incredibly expensive; they take too long to conclude; and their outcomes are uncertain. A company that envisions a rate case is derailed because railroads that hold them hostage are well aware of this and are adept at gaming the regulatory process. Business windows of opportunity open and close quickly and companies cannot put decisions on hold, waiting for the bureaucracy to work its cumbersome way.

Members of the Committee, I want to conclude by thanking you for the opportunity to present our concerns to you and to thank you for your interest in the concerns of our Louisiana plants that ship products by rail. We need the railroads and the railroads need us, but for so many of our companies it is a stretch of track that only goes in one direction, the one favoring the railroad.

We don’t want to be treated favorably, just fairly.

We therefore ask the Congress to:

- Make STB Reauthorization legislation a top priority in the 108th Congress. This legislation is one appropriate vehicle for making improvements in the shipper protections at the STB. The legislation should also authorize sufficient resources for the STB to discharge their responsibilities in a timely and efficient manner.
- Require the railroads to quote rates to move traffic across their bottleneck facilities to competing lines. This places these movements in commerce and provides a chance for a negotiation.
- Make shippers eligible for any loans and loan guarantees authorized for rail infrastructure projects.
- Empower the STB to be pro-active in investigating anti-competitive strategies and practices and empower it to take action.

Mr. Chairman, the status quo does not work for Louisiana captive rail shippers. The captive rail rates our members are being forced to pay are having an extremely negative impact on our industry in Louisiana. The Surface Transportation Board has made it clear that either they don’t care about our problems or they don’t have the authority or resources to help us. If you and your colleagues don’t act to help us, we will remain at the mercy of the railroads.

Thank you again for the opportunity to submit testimony.

PREPARED STATEMENT OF CAROLINA POWER AND LIGHT COMPANY

Mr. Chairman, Members of the Subcommittee:

This testimony is submitted on behalf of Carolina Power and Light Company (CP&L) to the Subcommittee on Surface Transportation and Merchant Marine in conjunction with the Subcommittee’s hearing addressing railroad rate and regulatory issues, and other service and competition matters. CP&L appreciates this opportunity to share its views and respectfully requests that this testimony be included as part of the hearing record.

A. CP&L AND ITS COAL-FIRED PLANTS

CP&L is a subsidiary of Progress Energy, Inc. (Progress Energy). Progress Energy is a Fortune 250 diversified holding company headquartered in Raleigh, NC, with $8.5 billion in annual revenues. Progress Energy is a regional energy company focusing on the high-growth Southeast region of the United States with more than 20,000 megawatts of generation capacity and serves approximately 2.9 million electric and gas customers. It is among the top 10 generators in the United States.

Through its wholly owned regulated subsidiaries, CP&L, Florida Power Corporation (Florida Power), and North Carolina Natural Gas Corporation, Progress Energy is primarily engaged in the generation, transmission, distribution, and sale of electricity in portions of North Carolina, South Carolina, and Florida; and the transport, distribution, and sale of natural gas in portions of North Carolina.

CP&L serves an area of approximately 34,000 square miles in portions of North Carolina and South Carolina, with a population of more than 4.0 million. Florida Power serves an area of approximately 20,000 square miles in Florida, with a population of more than 5.0 million. Approximately 40-percent of the Progress Energy generation is coal fired. Progress Energy's two major electric utilities, CP&L and Florida Power, procure, transport, and burn approximately 18 million tons of coal per year with 16 million tons dependent on rail transportation.

Fuel costs constitute a very substantial component of Progress Energy's overall cost of producing energy—and transportation costs are a very important part of those costs. Coal transportation costs are ultimately paid by Progress Energy's electricity customers. As a business entity and as a public utility that generally is permitted to pass the cost of fuel to its customers through fuel adjustment clauses, it is incumbent on Progress Energy to make every effort to ensure that the transportation expenses it incurs, and its customers pay, do not exceed reasonable levels.

In the case of CP&L, six of its eight coal-fired power plants are served solely by one railroad at destination, either Norfolk Southern Railway Company (NS) or CSX Transportation, Inc. (CSXT). In fact, because of the massive consolidation of the railroad industry in recent years, NS and CSX are the only two remaining "Class I" railroads operating in the majority of the eastern United States. Because NS and CSXT completely control the railroad service market in which all of CP&L's coal-fired plants are situated, CP&L is to a large extent at the mercy of the two railroads in obtaining transportation rates and service terms for the transportation of coal to its plants.

B. CP&L's COMPETITIVE PLIGHT AND RATE LITIGATION EXPERIENCE

The important message CP&L wishes to convey to the Subcommittee is that the competitive problems facing captive rail shippers are real. As discussed below, it is CP&L's experience that captive shippers are being targeted with unreasonable rate demands by the railroads. Because of considerable problems CP&L has experienced in obtaining reasonable rail rate and service terms at its captive facilities in the commercial marketplace, CP&L has had no practical alternative but to resort to regulatory relief at the Surface Transportation Board (STB) by filing a rate case.

1. *CP&L's Competitive Situation*

As indicated above, six of CP&L's eight coal-fired plants are captive to a single rail carrier at destination. This effectively gives the railroad that serves a particular plant a monopoly over the transportation of its needed coal supplies. This is particularly problematic with respect to CP&L's two-largest, baseload coal-fired plants, its Roxboro Station at Hyco, NC and its Mayo Station at Mayo Creek, NC, which are served only by NS. Collectively, these plants consume approximately 8 million tons of coal annually—or two-thirds of the total annual coal tonnage consumed at all of CP&L's coal-fired plants.

Over the years, NS has transported coal to Roxboro and Mayo under a series of private rail transportation contracts going back to the early 1980s. The parties' most recent contract expired March 31, 2002. Prior to the expiration of this contract, CP&L attempted to initiate meaningful negotiations with NS over the terms of a replacement contract for Roxboro and Mayo. Unfortunately, NS refused to negotiate with CP&L on any other basis than a large increase in CP&L's already high rate levels.

Unwilling to accede to NS's contract rate demands, CP&L sought and obtained from NS common carrier rates, effective April 1, 2002. The rates NS established are extraordinarily high ($16.56 and above per ton), significantly above the rates applicable under the parties' expiring contract, and far above and beyond anything NS has ever charged CP&L in the past.[1] Because CP&L has no practical rail or non-rail alternative for the transportation of coal to Roxboro and Mayo, and to be able to meet its system load requirements, it has little choice but to pay these NS exorbitant rates while they are being challenged at the STB. As fuel costs are passed directly through to CP&L's electric ratepayers, they are borne by the ratepayers as part of their monthly electric bills until such time as the STB orders them reduced.

2. *CP&L's STB Rate Case Complaint*

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[1] While CP&L would very much like to report to the Subcommittee the exact extent of the rate increases imposed by NS and being challenged at the STB, CP&L is precluded from doing so because its contract rate terms are confidential.

In early February, 2002 CP&L filed its rate complaint with the STB challenging the reasonableness of NS's rates for transporting coal to its Roxboro and Mayo plants, and seeking the prescription of maximum reasonable rates (and reparations). STB Docket No. 42072, *Carolina Power and Light Company* v. *Norfolk Southern Railway Company.* By decision served March 12, 2002, the STB adopted a procedural schedule, providing for the submission of three rounds of written evidence. As of this writing, the first round of evidence has been filed.

As CP&L's rate case is currently pending before the STB, this is not the time or place to discuss its merits. However, CP&L does want to comment on several important issues relating generally to railroad pricing and agency adjudication of rate cases, which it believes it is uniquely qualified to address, and which it believes will be helpful for the Subcommittee to understand as it evaluates the plight of captive rail shippers and the STB's rate-reasonableness process.

a. *Railroad Pricing Issues*

The railroads, and specifically NS, often tout the "fact" that rail rates have dropped for shippers, including coal shippers and even captive shippers, since passage of the Staggers Act in 1980. These "reductions" are completely illusory with respect to CP&L. In fact, both NS and CSX have made recent public pronouncements that they are attempting to engage in more proactive "value billing" for their services. From CP&L's perspective, that essentially is code for the railroads' attempts to squeeze all available profits from their captive customers. Such a price escalation strategy is exactly what NS is attempting to do in pricing CP&L's Roxboro and Mayo service.

The Class I railroads' industry trade association (the Association of American Railroads) has made the remarkable statement that there is a "myth that service to a shipper by a single railroad is equivalent to monopolization. In fact, railroads face extensive competition for the vast majority of their business, including cases where a customer is served by only one railroad." CP&L assures the Subcommittee that CP&L's status as a captive shipper subject to the railroads' monopolistic pricing demands, which have recently involved massive rate increases, is no "myth."

To put the rates presently being charged by NS to transport coal to CP&L's Roxboro and Mayo power plants in context, it is illustrative to examine the recent STB rate litigation experience of other captive coal shippers. A common method of comparing rates on rail movements of coal is to compare them on the basis of mills (thousandths-of-a-dollar) per revenue ton mile (dividing the rate per ton by the route mileage in the loaded direction). In the most recent coal rate case decided by the STB, Docket No. 42051, *Wisconsin Power and Light Co.* v. *Union Pacific R.R.*, Decision served September 13, 2002, the Board determined that the rate being challenged was unlawful, and prescribed a maximum rate (at 180 percent of the railroad's variable costs of service) equal to 10.5 mills to 10.7 mills.

In stark contrast, NS's common carrier rates for the Roxboro and Mayo movements are 4 to 5 times higher than those prescribed by the Board in the *Wisconsin* case, with some moves approaching 56 mills.[2] This comparison helps begin to explain the frustration experienced by CP&L over NS's imposed pricing scheme, and its decision to pursue regulatory intervention through its rate case.

b. *Rate Regulatory Protection Issues*

CP&L emphasizes that there is a continuing vital need for federal regulatory supervision of rail rates in situations where a railroad has market dominance (i.e., an absence of effective competition).[3] However, potential relief for captive shippers from unlawful pricing demands by the railroads can be only as effective as the underlying regulatory processes and standards that are in place to resolve rail rate disputes. In addition, the agency charged with administering these processes must have sufficient qualified personnel to carry out those important regulatory protection functions in a timely and efficient manner.[4]

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[2] The *Wisconsin* case involved a western coal movement. To be fair, CP&L acknowledges that western coal moves generally are less costly than eastern coal moves due to the hilly Appalachian terrain, smaller mines, and lack of "loop" tracks for loading, etc. Nevertheless, any such differences in rail costs certainly are a small fraction of the difference between the rates prescribed for Wisconsin Power and Light and the rates presently being charged by NS.

[3] To be clear, maximum-rate litigation is a last-resort remedy for CP&L, as it believes is the case for all captive shippers. However, in the absence of any other transportation options, and in light of NS' insistence in imposing substantial rate increases, CP&L's only alternative was to file its rate complaint with the STB to protect its electric ratepayers and its business from NS's monopoly pricing demands.

[4] CP&L believes the STB's existing *Coal Rate Guidelines*, under which its rate case is being evaluated, currently provide bulk shippers, the railroads, and STB staff with an acceptable ana-

Under its governing law and regulations, the Board is supposed to complete rate cases within 16 months (7 months for discovery and the completion of the evidentiary record and 9 months for the Board to decide the case). CP&L believes this time period is more than adequate for the Board to decide rate cases.[5] CP&L cannot emphasize enough the importance that the STB do all it can to keep rate cases as close as possible to the mandated 16-month schedule. This is especially important to CP&L because of the very high level of rail rates it must pay over the course of its pending rate case proceeding. CP&L is supportive of any Congressional efforts to assist the Board in this regard, to ensure that the STB has a sufficient number of qualified personnel and resources to accommodate its case load, so that it can process rate cases in a timely manner.

It is vitally important to have in place sufficient regulatory "back stop" protection laws, regulations, and processes to protect captive shippers from economic rate abuses by rail carriers. Based on CP&L's experience, the maintenance and improvement of such regulatory safeguards is as important today as it has ever been, if not more so given the railroads' recent pricing demands. Accordingly, it is critical that the Subcommittee closely monitor rate cases pending before the Board, and the governing regulatory processes, to ensure that shippers have an adequate remedy at law to address economic abuses by the railroads, and to ensure that the public interest is fully served.

CP&L thanks the Subcommittee for this opportunity to share its views.

LETTER DATED JULY 30, 2002 SUBMITTED BY GERARD J. DONNELLY, GLOBAL DIRECTOR, LOGISTICS, TO HON. JOHN BREAUX

July 30, 2002

Hon. JOHN BREAUX,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce Science, and Transportation,
Washington, DC.

Dear Senator Breaux:

RE: SENATE HEARINGS ON RAIL COMPETITIVENESS

E.I. DuPont de Nemours and Company (DuPont) would like to express its appreciation to you and your staff for agreeing to hold hearings on the current state of competition and service concerns affecting the freight rail industry.

DuPont, a U.S. corporation, headquartered in Wilmington, Delaware, is a global science and technology company engaged in the manufacture, sale and distribution of chemicals, crop protection products, paints, textiles, resins, plastics and related materials. Much of the raw material and finished products produced and/or utilized by DuPont's (insert number) U.S. manufacturing facilities are shipped by rail. In addition, as one of the largest exporter of U.S. manufactured chemicals and related products (according to Journal of Commerce figures, DuPont is currently the third largest U.S. exporter), DuPont is highly dependent upon the domestic rail system to service its global marketplace.

The events of September 11, 2001, traditional safety concerns and fundamental economics surrounding the transportation of hazardous materials and bulk products have served to increase DuPont's already heavy dependence on freight rail transportation. A strong, healthy and efficient freight rail industry is essential to DuPont's ability to compete both within the United States and abroad.

DuPont, however, is very concerned about the lack of effective competition within the rail industry. In 1980, when the Stagger's Rail Act was passed, Congress expressed it's concern about the then deplorable financial position present in the rail industry. The Stagger's Act recognized this condition and attempted to reduce expensive and counterproductive regulation in order to permit the industry to rebuild and recover its financial health.

In the years since the passage of the Stagger's Act, the rail industry has been substantially restructured and has dramatically improved its overall financial position. However, during this process in kind competition between rail carriers has been

lytical framework for evaluating the reasonableness of rates charged for market-dominant rail movements. CP&L also believes that the STB is currently the most appropriate forum to decide such complex cases.

[5] By way of reference, the STB's most recent major rail consolidation proceeding (completed in 1998), involving the acquisition of Conrail's assets by CSXT and NS, in which hundreds of partise participated, was completed only 13 months after the application was filed.

greatly reduced, The competitive market place forces which Congress had correctly relied upon to “regulate” the industry have all but disappeared. This has resulted in a substantial increase in the number of “captive shippers”, reduction in service (and security) options, a less responsive and innovative rail partner and the imposition of a “monopoly premium” in excess of 30-percent being imposed upon captive shippers

The time, therefore, has come to reexamine the Stagger’s Act and its underlying premise. New mechanisms must be imposed and used to restore in kind competition among in kind rail carriers where such competition does not currently exist. DuPont believes that such competition in the rail industry will result in improved overall freight rail service and will serve to aid the aid the rail industry in recapturing much of the freight and bulk transport business lost to motor carriers since the conclusion of WWII. The recapture of this business will increase the financial strength of the rail industry and result in a “win-win” solution for both the rail industry and its customers.

DuPont does not believe in regulation (or re-regulation) where market forces can be effective. However, if competitive market forces are absent, some workable substitution must be discovered and applied if our economy is to maximize its potential. DuPont is most willing to work with the railroads, the Surface Transportation Board and Congress to find a viable and mutually beneficial solution to our current problems. We welcome your interest and look forward to meeting with you and your staff to begin this worthwhile effort.

Respectfully submitted,

GERARD J. DONNELLY,
Global Director, Logistics, DuPont.

PREPARED STATEMENT OF ENTERGY SERVICES, INC.

Mr. Chairman, Members of the Subcommittee:

This testimony is submitted on behalf of Entergy Services, Inc. (“ESI”) to the Subcommittee on Surface Transportation and Merchant Marine on railroad rates, service, and competition issues. With the permission of the Subcommittee, ESI respectfully requests that this statement be included as part of the Subcommittee hearing record.

I. IDENTITY OF ESI/ENTERGY

ESI is a wholly-owned subsidiary of Entergy Corporation (“Entergy”), an investor-owned public utility holding company, which through its subsidiaries, engages principally in the electric power business, including electric utility sales. Entergy has five wholly-owned domestic retail electric utility subsidiaries: Entergy Louisiana, Entergy Arkansas, Entergy Gulf States, Entergy Mississippi, and Entergy New Orleans. These companies collectively provide retail electric service to approximately 2.6 million customers in Louisiana, Arkansas, Mississippi, and Texas, as well as engage in wholesale and governmental electric power sales. ESI provides management, administrative, and other services to these subsidiaries.

Among its responsibilities, ESI provides for the acquisition of coal and related transportation services by railroad for Entergy’s electric utility operating subsidiaries that utilize coal as a generating fuel. Coal transportation issues are of significant concern to ESI/Entergy because of the tremendous cost of purchasing coal transportation, and because these expenditures must ultimately be paid by electricity consumers as part of their monthly electric bills.

II. THE ENTERGY EXPERIENCE AND THE IMPORTANCE OF RAILROAD COMPETITION

ESI would like to convey to the Subcommittee the important message that policies enhancing railroad competition are in the best interest both of rail shippers, in promoting efficient and cost-effective service, and the railroads themselves, in promoting a healthy and responsive railroad service industry. ESI’s experiences with railroad service providers at Entergy Arkansas and Entergy Gulf States provide illustrative and supporting examples of this point.

A. Entergy Arkansas' Experience

Entergy Arkansas' White Bluff and Independence plants burn significant tonnages of western coal as a boiler fuel (each plant burns approximately 6.5 million tons of coal annually, for a total of approximately 13 million tons). All of this coal is transported to the plants by rail, as there is no other practical means of moving the plants' required tonnages. Entergy Arkansas is one of the nation's largest railroad customers, operating 17 continuously-running unit trainsets from mine origins in Wyoming to its White Bluff and Independence plants. Each trainset consists of 135 high-capacity aluminum cars supplied by Entergy.

Entergy Arkansas' present transportation arrangements for its White Bluff and Independence plants are pictorially described in the schematic attached as *Exhibit No.1.*

1. *Entergy's White Bluff Plant*

As shown in the attached schematic, two railroads, the Union Pacific Railroad Company ("UP") and the Burlington Northern and Santa Fe Railway Company ("BNSF"), serve the origin coal mines in the Wyoming Powder River Basin ("PRB") from which Entergy receives its coal. At destination, both of these carriers also serve its White Bluff plant (UP direct, and BNSF via trackage rights over UP to the plant). Obtaining dual carrier service at White Bluff was achieved only very recently (in 2001), and was the culmination of an extensive and involved process (including a severe UP service failure and accompanying litigation) which required tremendous effort, persistence, and expense on behalf of Entergy over a number of years.[1]

With the real prospect of rail-to-rail competition finally in-hand at its White Bluff plant, Entergy was, for the first time, able to negotiate contracts with two railroads for transportation of coal to the plant. With the leverage of marketplace competition, Entergy ultimately was able to obtain efficient and cost-effective dual-carrier service. It now utilizes both UP and the BNSF as service providers to meet the plant's coal consumption requirements through private rail transportation contracts.

While the terms of Entergy's contracts with the UP and the BNSF are confidential, ESI can state for the record that marketplace competition has worked very well. The economic benefits of this direct competition have inured directly to the benefit of Entergy Arkansas' retail electric customers in the form of pass-through reductions in its transportation-related electric generation fuel costs.

The Subcommittee is likely to hear testimony from the railroads that the industry is more than adequately meeting its customers' competitive service needs and expectations, and that in order to sustain their expensive infrastructure and to meet investor expectations, the railroads cannot "afford" to be forced to compete for their captive coal customers' service. The Entergy Arkansas experience at White Bluff is directly to the contrary. For years, UP's service to the plants was indifferent at best, and abysmal at worst (especially during the infamous UP service crisis following its merger with the SP)—even though Entergy is one of UP's largest customers. As indicated above, this horrible service record by UP led to several years of litigation between the parties.

When Entergy finally secured second-carrier access at its White Bluff plant allowing BNSF the opportunity to compete for its business, it was able to obtain competitive service terms and rates to the plant. Entergy's White Bluff plant has now been obtaining competitive rail transportation service from BNSF (and from UP) for the past year. Entergy emphasizes that BNSF is not forced to compete with UP for the White Bluff business. It does so voluntarily as a prudent business decision.[2]

Entergy's White Bluff experience demonstrates that competitively-set coal transportation rates will not financially ruin the railroad industry. (If it feared that it would, Entergy would not be advocating the promotion of railroad industry competi-

[1] BNSF trackage rights to serve the White Bluff plant were gained, in the face of strong opposition by the UP, through a combination of orders by the Surface Transportation Board ("STB") during the UP/Southern Pacific merger proceeding in the late 1990s and multi-year litigation with the UP over severe contractual service problems Entergy suffered under the parties' former rail transportation agreement.

[2] As noted above, BNSF serves the White Bluff plant via trackage rights over UP's lines. BNSF must pay UP trackage rights fees for use of its facilities to serve White Bluff. Because such fees, and the manner in which they are periodically adjusted, directly impact the competitiveness of alternate BNSF service to the plant, it is imperative that they be reasonable. This issue currently is the subject of a dispute at the STB between UP and BNSF over UP's attempts to include in its fees (for trackage rights acquired by BNSF as a result of the UP/Southern Pacific merger) the purchase premium UP paid for the acquisition of Southern Pacific. ESI views any attempts by UP to impose excessive trackage rights fees as completely unwarranted and anticompetitive, and it urges the Subcommittee to closely monitor this situation.

tion for fear of inhibiting its ability to obtain essential transportation service.) To the contrary, competition forces rail carriers to compete in the marketplace, and provide better rates and service. When rail carriers fairly compete in the open marketplace, competition provides lower-cost, more efficient, customer-focused service, while still generating substantial profits for the involved carriers.

2. *Entergy's Independence Plant*

In contrast to its White Bluff plant, Entergy's Independence plant remains captive to the UP for coal deliveries. As indicated on the attached schematic, two carriers reach the Independence plant, UP and the Missouri and Northern Arkansas Railroad ("MINA"). However, MNA, a "shortline," is effectively blocked from serving Independence by the terms of a lease agreement imposed by UP when it leased the trackage over which the MNA operates. That agreement, approved by the STB's predecessor, the Interstate Commerce Commission ("ICC"), imposes exorbitant penalty costs on the shortline if it interchanges more than a small percentage of traffic with a UP railroad competitor, and effectively prevents MNA from delivering BNSF-originated coal shipments to Independence in competition with UP.

The Subcommittee may be aware of so-called "paper barriers to interchange," by which is meant terms in rail line sales/lease agreements that penalize the buyer/lessor for interchanging traffic with competitors of the seller/lessor, or in some other fashion discourage or prevent such interchanges. Entergy Arkansas is a real-life example of a company competitively harmed by such a paper barrier. The MNA lease agreement is a good example. Relevant excerpts of that agreement are attached to this statement as *Exhibit No. 2.*[3]

There are two provisions in the MNA lease agreement that ESI would consider paper barriers. The first appears in Section 4.03, at pages 9 and 10. Under that provision if the MNA interchanges 95-percent or more of its traffic with the lessor (UP), the rent for the year is $0.00. If the MNA were to interchange more than 5-percent of its traffic with other carriers it would be required to pay annual rental amounts which begin at $10,000,000 and extend up to $90,000,000, based upon the percentage of traffic interchanged with other carriers.

As though that were not enough, the lessor (UP) also retains the right under Section 3.04 (page 8) to step in and provide exclusive service to Entergy Arkansas' power plant at Independence, upon seven days notice. These two lease provisions effectively eliminate the MNA as a viable competitive option. Were it not for these provisions, BNSF, in conjunction with the MNA, could provide a competitive alternative to UP from origin to destination.

ESI is unaware of any meaningful review by the STB (or the ICC) of the paper barrier issue and such barriers' impact on the railroad consuming public and the public interest. ESI also is unaware of any STB examination of the costs and other factors that the agency must balance when evaluating transactions that include unreasonable paper barriers to interchange (despite past requests from rail shippers that it thoroughly investigate such matters).

ESI understands that terms in short line sales/lease agreements that impose a stiff financial penalty on the short line for interchanging traffic with the sellers/lessor's competitors are not a new phenomenon. However, third parties are rarely privy to the terms of the sales agreements/leases, so as to be in a position to protest them. At a very minimum, Entergy believes that it is imperative that transactions including needlessly restrictive barriers to interchange should not be approved by the STB. Transactions including paper barriers should only be approved if they include the least restrictive impact on real or potential competitive service, and only then, if the transaction's benefits clearly outweigh the competitive harm caused by the barrier and the paper barrier extends over a reasonable period of time rather than in perpetuity.

ESI believes that the above-mentioned MNA lease agreement clearly constitutes a needlessly restrictive and anticompetitive paper barrier serving no justifiable public interest, and is completely unwarranted. Again, Entergy Arkansas has dual rail carrier service at both mine origin (UP and BNSF) and Independence plant destination (UP and MNA). Unfortunately, as described above, because of the involved paper barrier, Entergy Arkansas is foreclosed from utilizing MNA as a potential source of marketplace competition.

Given the STB's apparent lack of interest in resolving the important issue of paper barriers, ESI believes that congressional intervention through legislation is necessary to resolve this issue. ESI would be happy to work with the Subcommittee

[3] As the cover sheet reflects, this is a public document that was obtained from a 1993 filing with the Securities and Exchange Commission.

on drafting appropriate legislation to resolve this important public interest and marketplace competition issue.

B. Entergy Gulf States' Experience

Another example of recent competitive rail access at an Entergy power plant involves Entergy Gulf States' Roy S. Nelson power plant near Lake Charles, LA, which burns approximately 2.3 million tons annually of PRB coal. Until recently the Nelson plant was served exclusively by the Kansas City Southern Railway. In 1996–1997 Entergy Gulf States built a four-mile rail access line to the Southern Pacific. During the UP/SP merger proceedings Entergy sought a condition requiring UP to grant trackage rights to BNSF to serve Nelson so that it would have direct access to two competitive, single-line rail routes from the PRB all the way to Nelson via UP and BNSF. UP objected, and the STB denied the condition sought by Entergy.

After the merger was consummated, as part of a re-arrangement of UP's and BNSF's operations between Houston and New Orleans, UP voluntarily gave BNSF direct access to numerous industries in the Lake Charles area formerly served exclusively by UP, including the Nelson plant. Thus both carriers are in a position to compete head-to-head for the Nelson coal business as well as the KCS. Although detailed savings information cannot be provided because of contract confidentiality requirements, it can be said that the pay-back period for Entergy's competitive rail access ("build-out") project at Nelson has been well under two years.[4]

The Nelson, White Bluff, and Independence situations indicate that the major carriers pick-and-choose where they want to compete with each other for coal movements. They do not have any problem competing with each other where it suits other corporate purposes. But this kind of decision should not be left to the carriers. The public interest in efficient, reasonably-priced rail transportation service mandates giving the STB authority and direction to authorize competitive access in those situations where it is operationally feasible but the carriers have decided not to compete with each other.

ESI applauds the Subcommittee for commencing a review, through this hearing process, of substantive shipper protection and railroad competition issues. ESI believes that, given the STB's lack of attention to railroad competitive service issues, the time has come for the Congress to step forward and consider additional shipper protection measures, including elimination of unreasonable paper barriers, and to act to protect captive shippers from additional railroad economic abuses.

ESI is willing to consider any reasonable legislative alternative that would result in an increase of intramodal rail competition. It is important, however, that the Congress make clear that promoting competition—not protecting reluctant railroad competitors from marketplace competition—is the Board's principal obligation under the law.

ESI greatly appreciates this opportunity to present our views to the Subcommittee and will be pleased to provide the Subcommittee with any additional information it may need upon request.

[4] However, construction of competitive rail access at Entergy's remaining plant (Independence) is not feasible due to environmental concerns. Moreover, it would be a tremendous waste of resources because it would essentially duplicate existing rail facilities that cannot be used due to paper barriers.

Exhibit No. 1

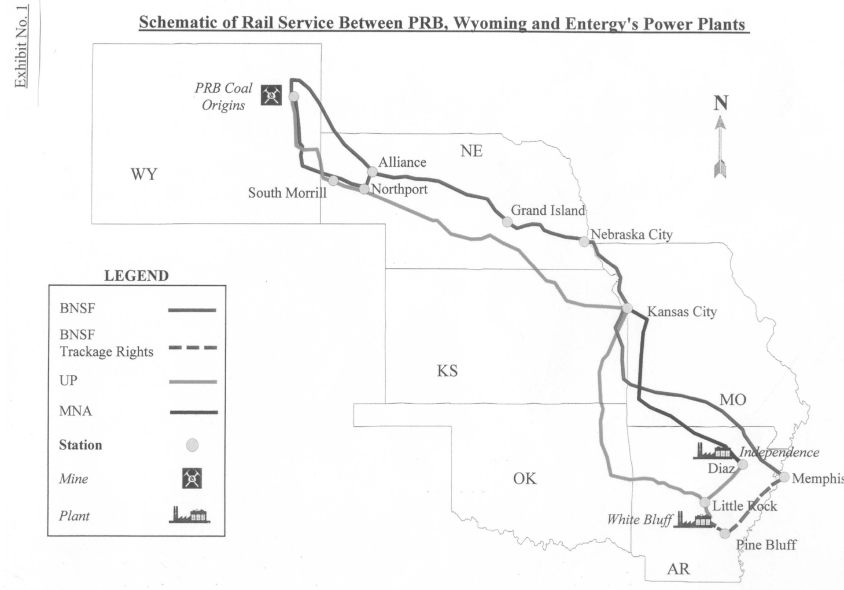
Schematic of Rail Service Between PRB, Wyoming and Entergy's Power Plants
PRB Coal Origins
WY
NE
Alliance
South Morrill
Northport
Grand Island
Nebraska City
Kansas City
KS
MO
OK
AR
Independence
Diaz
Memphis
Little Rock
White Bluff
Pine Bluff
N
LEGEND
BNSF
BNSF Trackage Rights
UP
MNA
Station
Mine
Plant

Exhibit No. 2

As filed with the Securities and Exchange Commission on November 19, 1993

BEST AVAILABLE COPY

Registration No. 33-68938

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Post-EF

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POST-EFFECTIVE AMENDMENT NO. 1

TO

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

RECD S.E.C.

NOV 1 9 1993

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#259-90

PROCESSED BY

RailTex, Inc.

(Exact name of Registrant as specified in its charter)

Texas	**4011**	**74-1948121**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

4040 Broadway, Suite 200
San Antonio, Texas 78209
(210) 841-7600
(Address, including zip code and telephone number, including area code of Registrant's principal executive offices)

Bruce M. Flohr
Chairman of the Board and President
RailTex, Inc.
4040 Broadway, Suite 200
San Antonio, Texas 78209
(210) 841-7600
(Name, address, including zip code and telephone number, including area code, of agent for service)

Copies to:

John D. Fisch, Esq.
Matthews & Branscomb
A Professional Corporation
106 S. St. Mary's, Suite 800
San Antonio, Texas 78205
(210) 226-4211

Joel S. Klaperman, Esq.
Shearman & Sterling
599 Lexington Avenue
New York, New York 10022
(212) 848-4000

Approximate date of commencement of proposed sale of securities to public: As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ☐

This Post-Effective Amendment No. 1 to the Registration Statement shall become effective on such date as the Commission, acting pursuant to Section 8(c), may determine.

Total of sequentially numbered pages 1166

Exhibit Index on sequential page number 87

LESSEE COUNTERPART

— ORIGINAL - DO NOT REMOVE

CONF

LEASE AGREEMENT

BY AND BETWEEN

MISSOURI PACIFIC RAILROAD COMPANY

AND

MISSOURI & NORTHERN ARKANSAS RAILROAD COMPANY, INC.

CON IDENTIA

DENTIAL

whether or not pursuant to necessary and proper regulatory authority as required by Section 3.02 of this Section III, Lessee will promptly relinquish to Lessor possession of the Leased Premises and this Lease Agreement will terminate as provided by Section XV of this Lease; PROVIDED, HOWEVER, any discontinuance of service or abandonment of any portion(s) of the Leased Premises which are inconsequential to rail freight service over the Leased Premises generally will be permitted and will not result in a termination of this Lease or require relinquishment of possession of the Leased Premises by Lessee.

SECTION 3.04—Lessor may acquire the right to operate over the Leased Premises between milepost 259.05 at Diaz Junction and milepost 270.00 near Independence to serve AP&L and, if this right is exercised, Lessee shall no longer have the right to serve AP&L, and AP&L shall become a closed industry served only by Lessor. This right shall be acquired effective seven days after Lessee's receipt of Lessor's written notice to Lessee that Lessor desires to begin operation over such trackage.

SECTION IV

RENT

SECTION 4.01.—In consideration of this Lease, and subject to the terms and provisions set forth herein, Lessee agrees to pay Lessor rent for the Leased Premises in the amount of Ninety Million Dollars ($90,000,000) per year payable annually in advance on the 1st day of March; PROVIDED, HOWEVER, that subject to the provisions of Section 4.02 hereof, for each lease year that 95-percent or more of all traffic originating or terminating on the Leased Premises is interchanged with Union Pacific Railroad Company or Missouri Pacific Railroad Company and any affiliated company, their successors and assigns, Lessor agrees that it will waive or partially waive the rent for that particular year in accordance with the schedule set forth in

Section 4.03, The 95-percent level must be achieved separately and simultaneously on the Pleasant Hill-Bergman (including connecting branches) and Guion-Diaz Junction segments.

SECTION 4.02—The following traffic shall not be counted in calculating either total traffic or the percentage of traffic in Section 4.03: (a) Industries open to reciprocal switching at Ft. Scott, KS; Lamar, MO; Joplin, MO; Carthage, MO; Aurora, MO; and Springfield, MO as shown in Exhibit C, and (b) traffic that is local to Lessee, i.e., traffic which both originates and terminates at stations on the Leased Premises or at the stations served by Lessee pursuant to the Line Sale Contract between Lessor and Lessee which is being executed by the parties concurrently with this Agreement, and not involving line haul movement by any railroad other than Lessee. Lessor will consider further exceptions to this section on a case by case basis.

SECTION 4.03—Upon request of Lessor, on or before the 1st day of February of each year following the commencement of this Lease, Lessee shall submit a report, signed by an officer of Lessee, certifying the amount and type of traffic originating or terminating on the Leased Premises during the prior calendar year, the railroads (if any) with which all or portions of such traffic were interchanged, the volume of traffic interchanged with each such railroad, and the total amount of rent due and payable for the previous calendar year. The rent due from Lessee for the Year shall be determined by reference to the percentage of the total traffic (as described in Section 4.01, subject to the provisions of Section 4.02) that was interchanged with Lessor, subject to the terms of Section 4.04, in accordance with the following schedule:

PERCENTAGE OF THE TOTAL TRAFFIC THAT WAS INTERCHANGED WITH LESSOR	RENT DUE LESSOR
100–95%	$-0-
94–85%	$10,000,000
84–75%	$20,000,000
74–65%	$20,000,000
64–55%	$30,000,000
54–45%	$40,000,000
44–35%	$50,000,000
34–25%	$60,000,000
24–15%	$70,000,000
14–5%	$80,000,000
0–4%	$90,000,000

Lessee shall pay to Lessor all rent determined to be payable pursuant to this Section 4.03 on or before March 1st for each calendar year following the commencement of this Lease.

SECTION 4.04—Rent shall be adjusted each year to reflect changes in the Producer Price Index—Finished Goods (the 'Index") and the amount due each year shall be determined as follows:

The Index for the month of December 1992 shall be deemed to be the base index ("Bass Index"). Rent shall be adjusted annually as of each December thereafter by multiplying the rent shown in Section 4.03 by a fraction, the denominator of which is the Base Index and the numerator is the Index for the month of December in each year. The term "Producers Price Index" shall mean the Producer Price Index—Finished Goods (Reference Base 1982—100), published by the United States Department of Labor, Bureau of Labor Statistics, or, if the Producer Price Index ceases to be published, such comparable index or measure of change in the

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Prepared Statement of Louisiana Energy & Power Authority

Mr. Chairman and Members of the Subcommittee:

On July 31, 2002, the Subcommittee on Surface Transportation and Merchant Marine held a hearing on railroad shipper concerns. The Louisiana Energy and Power Authority ("LEPA") is pleased to submit a written statement concerning these matters. We ask that this statement be included in the Subcommittee's hearing record.

LEPA was created by the Louisiana Legislature in 1979. LEPA consists of eighteen Louisiana cities and towns, each of which maintains its own independent municipal power system. LEPA's current members are the cities and towns of: Abbeville; Alexandria; Erath; Houma; Jonesville; Kaplan; Lafayette; Minden; Morgan City; Natchitoches; New Roads; Plaquemine; Rayne; St. Martinville; Vidalia; Vinton; Welsh and Winnfield.

LEPA is a joint-action agency working to provide its member communities with firm, stable sources of electricity at the lowest possible costs. LEPA is one of three co-owners of the coal-fired Rodemacher Power Station Unit No. 2 located in Boyce, Louisiana. Rodemacher Unit No. 2 is a 523 megawatt unit. This unit provides approximately 104.5 megawatts of power to LEPA. In July, 2002, the Subcommittee received testimony from Terry Huval, the Director of Lafayette Utilities Systems ("LUS"). LUS is also a co-owner of the Rodemacher Unit No. 2. LEPA joins in and supports Mr. Huval's oral statement, as well as the written testimony Mr. Huval submitted for the record.

As Mr. Huval outlined in detail in his written remarks, Rodemacher Unit No. 2 is a "captive" facility. This captivity arises because only one rail carrier serves the Rodemacher station and, as a practical matter, the only way that the Rodemacher station co-owners can receive their coal purchases at Rodemacher is by rail. These purchases are made from mines located in the Wyoming Powder River Basin ("PRB"). The distance between the PRB and Rodemacher is over 1500 miles.

The Rodemacher station rail captivity falls into the "bottleneck" category. Currently, all of our coal is being transported from the PRB to Rodemacher by a single rail carrier. However, a second rail carrier serves the PRB and that carrier, in conjunction with a third carrier, can carry our coal purchases all of the way to Alexandria, Louisiana—which is only 19 miles from Rodemacher. Unfortunately, the last 19 miles (between Alexandria and Rodemacher) is served only by our current rail carrier. As a consequence of this bottleneck captivity, LEPA pays transportation prices that are in excess of those that LEPA believes would be available if LEPA could obtain competitive rail pricing and rail service. These higher prices end up being paid by the electric customers of our members.

LEPA joins LUS in urging Congress to take actions to allow bottleneck rail shippers to enjoy the benefits of existing rail competition. This competition should produce lower, competitive rail prices. To this end, we support changes in current law that would overrule the Surface Transportation Board's Bottleneck Decision. Such changes would allow LEPA to obtain the benefits of competition between the PRB and Alexandria. We also support other proposed changes in the law that would assist captive shippers in obtaining competitive rail pricing.

On behalf of LEPA, I appreciate the opportunity to present our views to the Subcommittee.

Respectfully submitted,

LOUISIANA ENERGY AND POWER AUTHORITY
Cordell Grand,
General Manager.

PREPARED STATEMENT OF MINNESOTA POWER

Mr. Chairman and Members of the Subcommittee:

Minnesota Power, a division of ALLETE, appreciates the opportunity to present its written views on railroad shipper issues to the Subcommittee. We ask that this statement be included in the Subcommittee's July 31, 2002 hearing record.

INTRODUCTION

Minnesota Power's interest in railroad shipper issues is two-fold. First, Minnesota Power transports significant volumes of coal, by rail, to its electric generating facilities. These facilities include the Boswell Energy Center located near Grand Rapids, Minnesota and the Laskin Energy Center located in Hoyt Lakes, Minnesota. Both of these plants are served by a single rail carrier. Secondly, several of Minnesota Power's large power customers are heavily dependant on rail service for transportation of both inbound and outbound products. In many instances our customers' facilities are solely served by a single rail carrier.

Minnesota Power serves more than 130,000 electric customers and 16 municipal systems across a 26,000 square mile service territory in northwestern Minnesota. A Minnesota Power subsidiary sells electricity to 14,000 customers, natural gas to 12,000 customers, and provides water services to 10,000 customers in northwestern Wisconsin.

Minnesota Power also has a unique customer base. A dozen large power customers (requiring at least 10 megawatts of generating capacity) purchase about one-half of the electricity Minnesota Power sells. Minnesota Power's large power customers include five taconite producers who mine and process the iron-bearing rock that underlies the Missabe Iron Range. More than 60 percent of the ore consumed by integrated steel facilities in the United States originates from Minnesota Power's five taconite customers. Taconite processing requires large quantities of electric power. Minnesota Power's large power customers also include four paper and pulp manufacturers.

STATEMENT OF POSITION

In 1980, Congress enacted the Staggers Rail Act. The Staggers Act was designed and intended to balance both shipper and carrier interests. Since the Staggers Act was enacted, the nation's railroads have aggressively implemented the various pricing and consolidation freedoms the Staggers Act accorded to them. These actions, aided first by the Interstate Commerce Commission ("ICC") and subsequently, upon the sunset of the ICC, by the Surface Transportation Board ("STB"), have resulted in an unprecedented concentration of market power in a very few rail carriers. Just prior to the enactment of the Staggers Act, there were 42 Class I railroads. Today, that number has shrunk dramatically and the industry is dominated by a few behemoths.

No shipper in the past fifteen years has been able to successfully prosecute a case under the competitive access provisions in the Staggers Act. While the railroads, with the ICC/STB's active support, have aggressively implemented the railroad pricing and consolidation provisions in the Staggers Act, the same can not be said for other provisions in the Staggers Act designed to offset carrier monopoly pricing power. These provisions were designed to open up captive rail facilities to competition. Similarly, the Board's controversial 1996 decision in the *Bottleneck Case* effectively prevents bottleneck rail shippers from obtaining the benefits of competition. Finally, the ICC/STB maximum rate process does not work for smaller shippers. These shippers simply cannot afford to file and prosecute their cases under current STB standards.

Minnesota Power urges Congress to take necessary remedial actions to correct the above-referenced imbalance in the administration of the Staggers Act. To that end, Minnesota Power supports H.R. 141, Surface Transportation Reform Act, S. 1103, Railroad Competition Act of 2001 and S. 2245, Railroad Competition, Arbitration and Service Act. While each of these bills differs in their details, they all are intended to increase captive rail shippers' competitive options and to ease captive rail shippers' litigation burdens. These are important changes in the law that would preserve and enhance the goals Congress sought to achieve in the Staggers Act. Most importantly, they would restore a fair balance of shipper and carrier interests.

* * *

In conclusion, Minnesota Power would like to thank the Subcommittee, once again, for the opportunity to submit our written views for the record in this important hearing. Congress has an opportunity, and an obligation, to address the concerns of rail shippers and the millions of consumers who are paying more than they should for products that are transported by rail. Minnesota Power would be happy to provide any additional or supplemental information that the Subcommittee may need.

PREPARED STATEMENT OF WESTERN COAL TRAFFIC LEAGUE

Mr. Chairman, Members of the Subcommittee:

This statement is submitted on behalf of the Western Coal Traffic League ("WCTL") to the Subcommittee on Surface Transportation and Merchant Marine on railroad rate, regulation, and competition issues. WCTL respectfully requests that this statement be included as part of the Subcommittee hearing record.

IDENTITY AND INTEREST OF WCTL

WCTL is an association formed in 1976 whose membership is composed of shippers and receivers of coal mined west of the Mississippi River. A list of WCTL's current members is appended to this statement as *Exhibit A*. WCTL members ship by rail more than 95 million tons of western coal annually. Coal transportation issues are of great concern to WCTL because of the tremendous cost incurred by our members to purchase coal transportation, and because these expenditures must ultimately be paid by our members' customers as part of their monthly electric bills.

WCTL has actively participated in matters before the STB (and its predecessor, the Interstate Commerce Commission ("ICC")), the courts, and Congress involving coal transportation and coal supply issues, including the legislative deliberations that preceded Congress's enactment of the Staggers Rail Act of 1980 and the ICC Termination Act of 1995. WCTL participated in the STB's 1998 hearings in Ex Parte No. 575, *Review of Rail Access and Competition Issues*, which were held at the request of the Senate Commerce Committee. WCTL also most recently submitted testimony to the Subcommittee in the spring of 1999, the last time the Subcommittee formally addressed the reauthorization of the STB.

WCTL POSITION ON RAILROAD RATE AND COMPETITION ISSUES

A. The Efficient Processing of Rate Reasonableness Cases is Vitally Important

Appearing before the Subcommittee today is WCTL President Mark Schwirtz, Chief Operating Officer and Senior Vice President of Arizona Electric Power Cooperative, Inc ("AEPCO"). In his testimony, Mr. Schwirtz discusses the serious delays occurring in the processing of AEPCO's rail rate case pending at the STB, and the need for the Subcommittee to implement appropriate oversight to ensure that the agency is keeping cases on schedule. This issue also is of critical interest to WCTL and its other members.

Five rate cases involving WCTL members are currently pending at the STB, including Docket No. 42058, *Arizona Electric Power Cooperative* v. *The Burlington Northern and Santa Fe Ry. and Union Pacific R.R.* (the referenced AEPCO case); Docket No. 42056, *Texas Municipal Power Agency* v. *The Burlington Northern and Santa Fe Ry.*; Docket No. 42059, *Northern States Power Company Minnesota D/B/A Xcel Energy* v. *Union Pacific R.R.*; STB Docket No. 42057, *Public Service Company of Colorado D/B/A Xcel Energy* v. *The Burlington Northern and Santa Fe Ry.*; and Docket No. 41191, *West Texas Utils. Co.* v. *Burlington Northern Railroad Co.*[1] Several of the League's other members have been involved in earlier rate cases, and others may be involved in such cases in the future. Accordingly, the timely administrative processing and resolution of rate cases is very important to WCTL.

WCTL is supportive of the STB's existing *Coal Rate Guidelines*, under which its members' rate cases are being evaluated, as providing an appropriate legal and analytical framework for determining the reasonableness of rates charged for market-dominant rail movements. WCTL also believes that the STB is currently the most appropriate forum for deciding such complex cases. However, based on the excessive delay being experienced by AEPCO in the processing of its litigation, as detailed at length in Mr. Schwirtz's testimony, clearly something has run amuck in the administrative processing of its case.

If the STB can decide major Class I railroad merger proceedings, involving hundreds of parties, in just over a one year time period, surely it should be able to decide rate cases in the 16-month period as provided under the law and the STB's governing regulations. As described by Mr. Schwirtz in his testimony, this is especially important to WCTL members with pending cases at the STB, as these companies and their ratepaying customers must pay the high level of rail rates being challenged while their cases are pending, and may only obtain refunds at the end of the proceeding. Such delays also create operational problems for companies in making important fuel procurement decisions, and may ultimately act as a disincentive for shippers to seek rate protection at the STB to remedy a railroad's violation of the law.

Accordingly, WCTL encourages the Subcommittee to assist the STB to ensure that it has the sufficient staff personnel and resources to keep rate cases on schedule, and to monitor closely progress in handling these cases.

B. Rail Competition Issues

WCTL has testified before this Subcommittee in the past on its belief that the STB has interpreted its regulatory authority in a manner that emphasizes the railroad industry's financial needs at the expense of allowing competitive forces to operate as Congress intended when it enacted the Staggers and ICC Termination Acts. WCTL reemphasizes that the Board simply has not done enough to ensure that shippers are protected from the loss of competition resulting from the recent wave of mergers and consolidations in the railroad industry and from the railroads' refusal to adequately compete. For these reasons, it is essential that Congress act to protect captive shippers from the increasing economic power of an increasingly concentrated rail industry.

[1] Another rate case, Docket No. 42051, *Wisconsin Power and Light Company* v. *Union Pacific R.R.*, (STB Decision served Sept. 13, 2002) was recently decided by the STB, and is on appeal in the District Columbia Circuit in No. 02–1198, *Union Pacific Railroad Company* v. *Surface Transportation Board and United States of America*.

WCTL has participated with other shipper associations in the development of STB regulatory reform legislation, including S. 1103, the Railroad Competition Act of 2001 (sponsored by Subcommittee Members Rockefeller, Dorgan, and Burns) and S. 2245, the Railroad Competition, Arbitration and Service Act (sponsored by Senator Burns). WCTL has long recommended that the STB take several of the specific steps included in these bills to improve the competitive rail transportation options of rail shippers. This includes reconsideration and reversal of the Board's 1996 "Bottleneck" decision, and modification of the Board's "competitive access" rules (involving reciprocal switching and joint use of terminal facilities) by eliminating the requirement that the shipper prove anti-competitive conduct on the part of the incumbent rail carrier. Thus far, the STB has refused to adopt these proposals, indicating that it is the Congress, and not the Board, that should consider whether changes in the Board's enabling statutes are warranted.

WCTL understands that railroad competition issues are contentious, and that more than one option exists for dealing with the competitive problems in the rail industry. WCTL welcomes the opportunity to participate in a dialogue on these issues as a part of future substantive hearings on regulatory reform legislation, which it suggests the Subcommittee commence this coming Fall.

WCTL greatly appreciates this opportunity to present our views to the Subcommittee and will be pleased to provide the Subcommittee with any additional information it may desire on any of the matters discussed in this statement.

Exhibit 1

WESTERN COAL TRAFFIC LEAGUE MEMBERS

Alliant Energy
Arizona Electric Power Cooperative, Inc.
Associated Electric Cooperative, Inc.
Central Louisiana Electric Company, Inc.
City of Austin, Texas
City Public Service Board of San Antonio
Kansas City Power and Light Company
Lower Colorado River Authority
MidAmerican Energy Company
Minnesota Power
Nebraska Public Power District
NRG Power Marketing Inc.
Omaha Public Power District
Reliant Energy
Texas Municipal Power Agency
Western Resources, Inc.
Wisconsin Public Service Corporation
Xcel Energy